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	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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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Consent of Independent Registered Public Accounting Firm
Certification Per Section 302 by the Company's Chairman, Chief Executive Officer and President
Certification Per Section 302 by the Company's Chief Financial Officer
Certification Per Section 906 by the Company's Chairman, Chief Executive Officer and President
Certification Per Section 906 by the Company's Chief Financial Officer

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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.

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.

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.

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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

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.

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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

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

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.

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Item 6. Selected Financial Data.

The following tables set forth selected historical data for the years ended December 31, 2003 through 2007, derived from our audited financial statements for each such year and should be read in conjunction with such financial statements and the footnotes attached thereto as well as the discussion contained herein in *Management s Discussion and Analysis of Financial Condition and Results of Operations* . Certain prior period amounts have been reclassified to conform to the current period presentation.

	Year Ended December 31,				
	2007	**2006**	**2005**	**2004**	**2003**
Statements of Operations Data:					
Net sales	$ 82,209,963	$ 97,840,126	$ 87,312,560	$ 63,637,285	$ 43,520,563
Income (loss) before extraordinary gain, accrued dividends on preferred stock and income taxes	(12,530,850)	968,585	3,583,370	1,369,983	(665,921)
Preferred stock dividends from beneficial conversion feature	(943,838)				
Accrued dividends on preferred stock	(136,957)		(235,367)	(276,000)	(276,000)
Income (loss) before extraordinary gain and income taxes	(13,611,645)	968,585	3,348,003	1,093,983	(941,921)
Net income tax benefit	3,662,082	835,937	4,449,682		
Income (loss) before extraordinary gain	(9,949,563)	1,804,522	7,797,685	1,093,983	(941,921)
Extraordinary gain, net of income tax	432,403			173,536	2,962,041
Net income (loss) applicable to common stock	$ (9,517,160)	$ 1,804,522	$ 7,797,685	$ 1,267,519	$ 2,020,120
Net income (loss) per common share before extraordinary gain [(1)] (Basic)	$ (0.21)	$ 0.04	$ 0.22	$ 0.03	$ (0.03)
Net income (loss) per common share before extraordinary gain [(1)] (Diluted)	$ (0.21)	$ 0.04	$ 0.19	$ 0.03	$ (0.03)
Extraordinary gain per common share (Basic)	$ 0.01			$ 0.01	$ 0.10
Extraordinary gain per common share (Diluted)	$ 0.01			$ 0.00	$ 0.10
	$ (0.20)	$ 0.04	$ 0.22	$ 0.04	$ 0.07

Net income (loss) per common share after extraordinary gain (Basic)					
Net income (loss) per common share after extraordinary gain (Diluted)	$ (0.20)	$ 0.04	$ 0.19	$ 0.03	$ 0.07
Weighted average number of shares outstanding (Basic)	47,030,850	41,990,150	35,861,060	31,815,067	30,017,661
Weighted average number of shares outstanding (Diluted)	47,030,850	45,881,498	40,475,244	41,070,289	30,017,661
Balance Sheet Data:					
Working capital surplus (deficit)	$ 2,226,615	$ (3,466,130)	$ (687,039)	$ (3,470,971)	$ (1,915,695)
Total assets	93,758,803	72,049,966	56,952,673	43,340,793	36,406,601
Long-term debt less current maturities.	26,504,264	16,827,717	17,010,889	15,571,068	16,659,241
Total liabilities	63,683,674	44,493,361	35,835,369	31,610,279	27,458,156
Stockholders equity	30,075,129	27,556,605	21,117,304	11,730,514	8,948,445

(1) The net income (loss) per share of common stock is based on the combined weighted average number of shares of Class A and Class B common stock outstanding during the period. See Note 2 to the financial statements for a reconciliation of the basic and diluted weighted average number of shares outstanding.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

2007 Summary

2007 was a very challenging year for the building materials industry and for AERT, marked by lower sales in our overall decking segment as customer inventories were reduced toward year end 2007. The inventory reduction was mandated despite year over year growth in sales of AERT products in the HIW segment via the end customer, Lowe s. The combination of lower sales and higher cost of materials decreased factory utilization, increased over costs, and led to a significant loss for the year.

Current Business Environment

With the current economic uncertainties and the negatives surrounding homebuilding, following are the factors we believe will drive AERT s business in 2008.

Sales

The slowdown in the residential real estate industry has negatively impacted, and will continue to negatively impact, sales of building materials in the U.S. There is some evidence that in weak home sales markets, homeowners will spend on remodeling instead of moving up to a larger home. Outdoor decks have historically been one of the most popular home remodeling projects. We expect this trend to continue as contemporary deck designs are making outdoor decks an extension of the home, with many projects involving multiple levels, outdoor kitchens, spas, flower boxes, and so forth.

Sales of ChoiceDek decking and railing to Weyerhaeuser were $58.9 million in 2007 down from $78.1 million in 2006. As a percentage of overall sales product mix, $58.9 million 2007 sales were 71% compared to $78.1 million 2006 sales, or 80%. Although retail sales of ChoiceDek increased in 2007 compared to 2006, it was at a reduced rate compared to prior years and general economic conditions required Weyerhaeuser, our customer, to reduce inventories at year end. Sales of MoistureShield decking in 2007 were $16 million, up from $9.1 million in 2006, a 76% increase. MoistureShield decking sales were 20% of total sales in 2007 compared to 9% in 2006. Sales of MoistureShield decking increased in 2007 as the company continued to increase distribution and add lumber dealers throughout the U.S. and Canada.

Sales of OEM or industrial components were $7.3 million in 2007 compared to $10.6 million in 2006, a 31% decrease. Sales to Therma Tru Doors were $4.2 million in 2007, or 58% of total sales for that niche.

As manufacturing technology and aesthetics of composite decking improve, market trends continue to shift. Consumers are demanding more variety and selection as construction of multi-color decks appears to be increasing. Also, the evolution toward a more natural wood look is increasing on the higher end of the market, while decreasing wood prices have widened the price differential on the lower end. Thus, a smaller profile deck board, under the brand Basics™, was introduced in 2007 in limited colors, and targeted to a wood upgrade segment for light residential construction. We believe this will allow us to broaden our customer base and appeal to a wider market segment than in prior periods.

The MoistureShield decking introduction was 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 continue to require converting customers away from competing products to our brands such as MoistureShield or ChoiceDek. Thus, a significant marketing effort, through a national advertising agency, was initiated during the fourth quarter of 2007, and will continue throughout 2008. The marketing program is aimed at converting high end customers to our products.

With difficult conditions facing the decking market, AERT is differentiating its products through a combination of low 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.

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.

Four new regional building products distributors began carrying MoistureShield decking in 2007 and as of December 31, 2007 we had 14 regional distributors with twenty-five locations carrying our products. We anticipate additional new distributors

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coming on board in 2008, and we expect to see continued growth in that brand. In late 2007, we brought on a new customer that will be the exclusive distributor of MoistureShield in China. We are preparing to ship our second order of containers, and we are working to establish distribution throughout China. The Chinese economy is strong, with a growing middle class that aspires to Western-style homes and amenities such as composite decks. We expect that these factors will continue to drive AERT sales despite a continued weak outlook for the U.S. homebuilding industry.

Costs

Our materials costs are higher compared to prior years, 37.0% as a percentage of sales in 2007 compared to 35.6% in 2006 and 32.2% in 2005, as we have begun using expensive additives and additional equipment designed to increase color and improve aesthetics on decking boards, both of which are increasingly demanded by customers. As our volume grows, we believe we will be able to purchase and use these additives on more favorable terms, or possibly produce some of them in-house. We intend to improve yield and throughputs over time. We also intend to continue to utilize technology to source and reclaim increased volumes of lower cost plastic materials in-house.

We have invested significantly in plastic recycling infrastructure over the last several years. As technology has improved so have the aesthetics of our products, which are overwhelmingly comprised of recycled materials. Green building is an ever increasing trend and we intend to capitalize on that trend with a new slogan: AERT We Make Green Look Good.

The slowdown in the building products industry has dealt a harsh blow to cabinet and hardwood flooring manufacturers, from whom we acquire scrap wood fiber. The use of wood pellets as an alternative fuel source has also grown in the last few years. These two forces are acting to raise the cost of our wood raw materials, and we are looking at alternative sources of wood fiber.

Longer Term Factors Driving Our Business

AERT s core competency is extracting value from America s waste stream. As the market matures for our current slate of products made from recycled plastics, AERT will pursue new products and new markets. Given the many commercial uses of polyethylene, we believe that AERT has abundant growth opportunities. We have recently filed a new patent application relating to our advanced plastic recycling technologies, which we expect to result in the issuance of several patents. Additionally, we expect to file more applications over the next year. However, there is no assurance that patents will ultimately be issued, or if issued, that our claims will be granted as submitted.

In late 2007, we completed the financing required to build a new plastic recycling facility in Oklahoma. We are preparing to start construction in the second quarter 2008. The new facility is designed to allow us to use the less desirable, but also less costly, forms of waste polyethylene as well as additional sources of waste wood fiber, which will ensure our ability to maintain a low cost structure and possibly address additional sales and revenue opportunities.

We started the first line at the Springdale South plant during 2007, and it is now our best performing facility. We also upgraded our existing Springdale North plant during the fourth quarter of 2007, and expect to see further efficiencies there in 2008 versus prior periods. The installation of the next three lines at South will be relatively fast and we should be able to increase production capacity relatively quickly as demand picks up or new markets are opened.

As the decking market matures, some of our competitors with high cost processes are falling by the wayside; however, several new vinyl based products are entering the market. We are monitoring the activities of our competitors and moving into markets where our competitors are failing.

Management s Focus for 2008

Complete the expansion of the distribution network for our MoistureShield decking product line to nationwide distribution by the summer of 2008

Expand our business in China and explore opportunities in other growing international markets

Continue to expand sales in the HIW segment through Lowe s

Decrease operating costs relative to sales revenue:

Complete modifications to our plastic blending processes to increase throughput and increase yield at extrusion factories

Increase our ability to use more low cost raw materials

More aggressive raw materials purchasing strategies

Improve training and associate development

Increase automation to improve yield and lower labor costs

Streamline logistics and manufacturing operations

Complete installation of the new enterprise resource planning system to improve management information

Balance sales, general and administrative overhead expenses to match growth rate

Reduce leverage and strengthen the balance sheet

Growth Objectives

Our long term goal is to become the premier manufacturer and producer of exterior green building products. To accomplish this we are focused on the following:

1. ***Technological Innovation***

   Investments in leading edge recycling technologies have now entered the commercial phase with recent additions at our Lowell, Arkansas and Springdale, Arkansas manufacturing facilities. Additional technology is also underway with the Company s Watts, Oklahoma facility which is designed to recover, utilize, and convert lower grades of waste plastics into usable feedstocks. By utilizing technology, we are upgrading the quality and aesthetics of our products to levels equal to or better than virgin resin based materials from primarily a low end stream base of raw materials.

2. ***Green Marketing and Branding Focus***

   We have been recycling plastic and building green building products since our inception in 1988. We have recently retained the services of a national advertising and marketing firm, Nicholson-Kovac of Kansas City, Missouri to help build brand awareness for our MoistureShield product line. This involves expanded internet marketing, trade publications, and consumer and media marketing. We intend to continue building our brands and differentiating AERT as a green building products company.

3. ***Quality and Continuous Improvement***

   Our products are built for hostile, external environmental conditions. Our recycling processes focus on intensive cleaning and reformulating of our raw materials prior to extrusion. Our extrusion process is unique and focuses on total encapsulation of the wood fibers. Our products are covered under U.S. Patent #5759680.

   Since inception, we have focused on continuous improvement in our processes, products, and customer service.

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With our latest technological advances in plastic recycling, we are taking recycled plastics up to performance levels of new plastics, while also continuing to improve the surface aesthetics and other properties of our finished products. In the future, commercial implementation of our latest plastic recycling technologies may provide additional revenue opportunities beyond composites.

4. ***Distribution, Sales, and New Products***

We are broadening our distribution and sales beyond the HIW market in 2008 and further expanding into the commercial contractor and international markets. In addition to increased MoistureShield distribution, we have added several new tropical hardwood colors and are prepared to introduce a new line of matching embossed handrail kits. We are also finalizing field testing of a new line of exterior fencing which we intend to launch in the second half of 2008.

We have recently begun exporting decking products beyond North America with shipments to China and the Middle East. Exportation of our green building product is a major focus for our future.

5. ***Cost Improvements***

We have invested substantially over the last several years in facilities and equipment in order to attain increased sales capabilities. In addition, we have implemented several cost reduction programs involving process and automation improvements and the consolidation or closing of less efficient facilities. We have recently hired a new President and named a V.P. of Operations, both of whom are focused on the implementation of lean manufacturing and other efficiency processes while attaining improved cost efficiencies. Our focus is to utilize technology and infrastructure to convert low cost waste materials in to high quality, outdoor green building products with a significant cost advantage.

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We believe the selected sales data, the percentage relationship between net sales and major categories in the Statements of Operations and the percentage change in the dollar amounts of each of the items presented below is important in evaluating the performance of our business operations. We operate in one business segment and believe the information presented in our Management s Discussion and Analysis of Results of Operations and Financial Condition provides an understanding of our business segment, our operations and our financial condition.

Results of Operations

Three Year Comparison

	2007	% Change	2006	% Change	2005
Net sales	$ 82,209,963	-16.0%	$ 97,840,126	12.1%	$ 87,312,560
Cost of goods sold	74,340,601	-4.2%	77,594,965	16.9%	66,389,964
% of net sales	90.4%	11.1%	79.3%	3.3%	76.0%
Gross margin	7,869,362	-61.1%	20,245,161	-3.2%	20,922,596
% of net sales	9.6%	-11.1%	20.7%	-3.3%	24.0%
Selling and administrative costs	16,368,725	-0.2%	16,407,400	12.4%	14,595,854
% of net sales	19.9%	3.1%	16.8%	0.1%	16.7%
Research and development	265,881	-7.0%	285,858	159.6%	110,134
Subtotal	16,634,606	-0.4%	16,693,258	13.5%	14,705,988
% of net sales	20.2%	3.2%	17.1%	0.3%	16.8%
Operating income (loss)	(8,765,244)	*	3,551,903	-42.9%	6,216,608
% of net sales	-10.7%	-14.3%	3.6%	-3.5%	7.1%
Other income (expense)					
Net litigation contingency		0.0%		-100.0%	(610,206)
Gain (loss) on disposition of equipment	7,920	-86.4%	58,285	*	(26,122)
Net interest expense	(3,773,526)	42.8%	(2,641,603)	32.3%	(1,996,910)
Income (loss) before extraordinary item, accured premium on preferred stock and taxes	(12,530,850)	*	968,585	-73.0%	3,583,370
% of net sales	-15.2%	-16.2%	1.0%	-3.1%	4.1%
Preferred stock dividends from beneficial conversion feature	(943,838)	*		0.0%	
Accrued premium on preferred stock	(136,957)	*		-100.0%	(235,367)
Income (loss) before extraordinary item and taxes	(13,611,645)	*	968,585	-71.1%	3,348,003
% of net sales	-16.6%	-17.6%	1.0%	-2.8%	3.8%
Net income tax benefit	3,662,082	338.1	835,937	-81.2%	4,449,682
% of net sales	4.5%	3.6%	0.9%	-4.2%	5.1%
Income (loss) before extraordinary item	(9,949,563)	*	1,804,522	-76.9%	7,797,685
% of net sales	-12.1%	-13.9%	1.8%	-7.1%	8.9%

Extraordinary gain on involuntary conversion of non-monetary assets due to fire	432,403	*		0.0%	
Net income (loss) applicable to common stock	$ (9,517,160)	*	$ 1,804,522	-76.9%	$ 7,797,685
% of net sales	-11.6%	-13.4%	1.8%	-7.1%	8.9%

* Not meaningful as a percentage change

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Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Net Sales

Net sales for the year ended December 31, 2007 dropped 16% compared to 2006. Our MoistureShield decking sales were up 76% in 2007 compared to 2006 as a result of our aggressive plans to diversify our customer base. However, our ChoiceDek sales, which comprise the largest portion of our sales, were down 24%, resulting in an overall decline in our sales. Sales of ChoiceDek were lower in 2007 than in 2006 as a result of Weyerhaeuser reducing their system-wide ChoiceDek inventory levels compared to average levels kept on hand in 2006, even though unit sales of ChoiceDek products to end users were higher in 2007 than 2006. We expect higher ChoiceDek sales in 2008 than in 2007 because we believe that Weyerhaeuser s inventory adjustment is complete and that 2008 sales of ChoiceDek to end users will be comparable to 2007.

MoistureShield sales were significantly higher in 2007 than 2006 as we were successful in adding new distributors and gaining market share. Several new distributors joined the program in late 2007, so we expect higher MoistureShield sales in 2008 than in 2007, provided that the economy, and building and remodeling activity in particular, does not suffer significant further deterioration.

Sales of our OEM products decreased 31% from 2006 to 2007, as the slowdown in the homebuilding industry negatively impacted our OEM customers. We have ceased production of window components and reduced factory overhead, and we do not expect increased sales of OEM products in 2008 versus 2007. Sales of primed window components were approximately $1.6 million in 2007.

Cost of Goods Sold and Gross Margin

Cost of goods sold, as a percent of sales, increased to 90% for the year ended December 31, 2007 from 79% for 2006. The increase in costs resulted from higher material costs and a lower level of production that did not allow us to fully utilize our facilities; i.e. we were carrying too much overhead in relation to our sales and the added overhead costs lowered our overall margins. The decrease in sales combined with higher costs as a percent of sales led to a decrease in gross profit margin to 10% for 2007 from 21% in 2006.

Beginning in the second half of 2007, when it became apparent that the economy was weak and not improving, management undertook a broad move to realign the Company s overhead and cost structure with current economic conditions, and staffing levels were reduced. In response to higher transportation costs and slower sales growth, we suspended extrusion operations at the Junction extrusion plant and moved the productive assets from the Alexandria facility to our main recycling facility at Lowell, Arkansas. Also, to improve margins, and in response to growing raw material costs, we raised prices on our ChoiceDek and MoistureShield products effective January 1, 2008. We are also working to reduce plastic raw material costs with the addition of a new plastic recycling facility near Watts, Oklahoma, which we intend to bring on line by the end of 2008.

Selling and Administrative Expenses

Selling and administrative costs decreased slightly in 2007 compared to 2006 as the result of an effort to reduce excess overhead that had been added to support our rapid growth through the first half of 2006. As a percentage of net sales, selling and administrative costs increased to 20% from 17%. The categories of salaries and benefits, advertising and promotion, travel and entertainment, professional fees, and commissions together made up approximately 75% of total selling and administrative expenses in 2007. Professional fees were lower in 2007 than 2006, though we may have substantial legal fees again in 2008 due to lawsuits that were initiated in 2008 (see Litigation).

Income (loss)

The operating loss for 2007 was 11% of sales as compared to the operating income of 4% in 2006. We incurred a net loss of $9.5 million, or $0.21 per share, in 2007, compared to net income of $1.8 million, or $0.04 per share, in 2006. We recorded an extraordinary gain net of tax in the amount of $432,403 for the receipt of insurance proceeds related to a fire at our Junction, Texas facility in 2003. Additionally, we recorded $943,838 in preferred stock dividends for the beneficial conversion feature of the Series D preferred stock.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Net Sales

Despite the second half slowdown, AERT net sales were up 12.1% over 2005, the tenth consecutive year of sales growth. Prices were approximately 8.5% higher than prices prevailing in 2005, helping both our Weyerhaeuser ChoiceDek and MoistureShield decking sales register double digit growth. ChoiceDek sales increased $12.4 million (19%) and MoistureShield sales increased $1.4 million (18%). Sales of our OEM products, which are primarily associated with new home construction, fell off significantly in the second half of 2006, resulting in a decrease of OEM sales by $3.3 million (24%).

Cost of Goods Sold and Gross Margin

Cost of goods sold, as a percent of sales, increased to 79% for the year ended December 31, 2006 from 76% for 2005. Labor costs were down, as a percent of sales, due to increased automation and efficiency initiatives. Manufacturing overhead costs were up slightly, as a percent of sales, versus 2005 as increased employment and utility costs offset gains from increased scale. Raw material costs were up significantly due to higher costs of polyethylene scrap prices in the first half of the year. Prices eased in the second half.

Gross profit margin decreased to 21% for 2006 from 24% in 2005 as higher raw material and overhead costs outweighed the effects of lower direct labor.

Selling and Administrative Expenses

Selling and administrative costs increased approximately $1.8 million (12.4%), in 2006 compared to 2005 as a result of increases in personnel expenses and general increases in corporate costs to manage our growing business. Personnel expenses increased approximately $1.16 million, accounting for about 64% of the increase; travel expenses, primarily for sales and customer service, increased approximately $430,000, accounting for about 24% of the increase; and a mixture of other expenses accounted for the remaining 12% of the increase.

As a percentage of net sales, selling and administrative costs increased to 17.1% from 16.7%. The categories of salaries and benefits, advertising and promotion, travel and entertainment, professional fees, and commissions together made up 77% of total selling and administrative expenses in 2006. Professional fees were lower in 2006 than 2005.

Operating Income

Operating income was 4% of sales for 2006, down from 6% of sales in 2005 as higher raw material and overhead costs outweighed the effect of lower direct labor.

Net Income

Net income decreased to $1.8 million, or $0.04 per share, in 2006 from $7.8 million, or $0.19 per share, in 2005. Income before income taxes for 2006 was $968,585, down from income of $3,348,003 in 2005. We recorded a net income tax benefit of $835,937 in 2006, which consisted of the current tax provision for the year of $128,380 and a deferred tax benefit of $964,317. The deferred tax benefit was the result of temporary differences between amounts recorded for financial reporting purposes and amounts recorded for tax purposes, including amounts for net operating loss carryforwards and net property, plant and equipment.

Contingencies

Liquidity and Capital Resources

At December 31, 2007, we had a working capital surplus of $2,226,615 compared to a working capital deficit of $3,466,130 at December 31, 2006 attributable to our fourth quarter 2007 preferred stock and bond financings. Our working capital at December 31, 2007 included total current liabilities of approximately $37 million, of which $4.9 million was for accrued expenses, $9.6 million was in payables and $22.5 million was a combination of short-term notes payable, secured by inventory and receivables, and the current portion of long-term debt. We spent approximately $6 million on capital expansion during 2007. Expenditures were primarily for construction at our Springdale South manufacturing site and additional equipment at our Lowell plastic processing facility.

Unrestricted cash decreased $448,051 to $1,716,481 at December 31, 2007 from December 31, 2006. Significant components of that decrease were: (i) cash used in operating activities of $14,076,928, which consisted of the net loss for the period of $9,517,160 increased by depreciation and amortization of $5,068,789 and decreased by other uses of cash of approximately $11,180,289; (ii) cash used in investing activities of $3,826,559; and (iii) cash provided by financing activities of approximately $17,455,436. Payments on notes during the period were $5,022,017, including approximately $1,750,000 to Brooks Investment Company, a related party. Proceeds from the issuances of notes amounted to $19,265,000, including $750,000 from Brooks Investment Company, and net borrowings on our line of credit were $2,243,378. At December 31, 2007, we had bonds, capital leases, and notes payable in the amount of $48,999,856, of which $22,495,592 was current notes payable and the current portions of long-term debt and capital lease obligations.

At the end of the first quarter of 2006, we entered into a new $15.0 million bank line of credit, replacing the factoring agreement with Brooks Investment Co. that was in use during 2005 and the first quarter of 2006. No amounts were borrowed under the line of credit until April 1, 2006. The line is a one year revolving credit facility that was renewed in September 2007, and will mature in June 2008, secured by our inventory, accounts receivable, chattel paper, general intangibles and other current assets, as well as by fixtures and equipment, and is provided by Liberty Bank of Arkansas at a variable interest rate of prime plus one hundred basis points, which was 8.25% at December 31, 2007. The maximum amount that may be drawn on the line at one time is the lesser of $15.0 million and the borrowing base, of which approximately $1.9 million was available to borrow at December 31, 2007. The borrowing base is equal to the sum of approximately 85% of our qualifying accounts receivable, 75% of finished goods inventory and 50% of all other inventory. The full amount of the line is guaranteed as to payment by our largest stockholder, Marjorie S. Brooks, who also guarantees $4 million on our 2003 industrial development bond owned by Allstate Investments. When the line of credit matures, the Company intends to seek a line of credit that does not require a personal guarantee. The revolving credit facility includes debt service coverage ratio, current ratio, and accounts payable and accounts receivable aging 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 (see Note 4: Line of Credit). There is no assurance that we can receive a more favorable line of credit or that our existing working capital line of credit will be renewed when it matures in June 2008.

A prolonged period of reduced sales resulting from weakness in the building products industry or otherwise, however, could require us to slow or close production at some of our less efficient facilities and/or to seek additional funding in the form of debt or equity. There is no assurance that we would be successful in securing additional capital if required.

In addition to the construction of our Watts plastic recycling facility, our capital improvement budget for 2008 is currently estimated at $4 million, of which we believe we can finance half from our recent equity placement; the balance of required funds must come from cash flow. The 2008 capital improvement program will emphasize operating efficiency and improving our gross profit margin and cash flow, including automation projects and installing an enterprise resource planning system.

Under our 2003 and 2007 bond agreements, AERT covenants that it will maintain certain financial ratios. If we fail to comply with certain of the covenants, or to secure a waiver therefrom, the bond trustee would have the option of demanding immediate repayment of the bonds. In such an event, it could be difficult for us to refinance the bonds, which would give the bond trustee the option to take us into bankruptcy.

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We were not in compliance with the debt service coverage and accounts payable covenants as of December 31, 2007. The bond trustee waived the debt service coverage covenant as of December 31, 2007 through, and including, March 31, 2008, and waived the accounts payable covenant as of December 31, 2007 through, and including, December 31, 2008. Our line of credit contains all of the financial covenants listed below, with the exception of the debt to equity covenant, and the bank lender has also waived any noncompliance with such covenants. None of our other loans contain financial covenants.

Our Allstate notes payable and $1.6 million Regions Bank note payable have cross-default provisions that caused them to be in technical default at December 31, 2007 due to our non-compliance with the loan covenants discussed above. The covenants were waived by Allstate Investments, which is the investor in the bonds and the holder of the Allstate loans. As the Regions Bank loan was paid in full in February 2008, it has been classified as a current liability at December 31, 2007, and a waiver was not needed.

Bonds payable and Allstate Notes Payable Debt Covenants	**December 31, 2007**	**Compliance**
Long-term debt service coverage ratio for last four quarters of at least 2.00 to 1.00	-1.48	No Waived
Current ratio of not less than 1.00 to 1.00	1.06	Yes
Debt to equity ratio of not more than 3.00 to 1.00	1.63	Yes
Not more than 10% of accounts payable in excess of 75 days past invoice date	23.2%	No Waived
Not more than 20% of accounts receivable in excess of 90 days past invoice date	5.4%	Yes

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported on our financial statements. The estimates made in applying the accounting policies described below are material to the financial statements and notes thereto due to the level of judgment involved in arriving at those estimates.

Accounts Receivable

Trade accounts receivable are stated at the amount management expects to collect from outstanding balances. Delinquency fees are not assessed. Payments of accounts receivable are allocated to the specific invoices identified on the customers remittance advice. Accounts receivable are carried at the original invoice amount less an estimated reserve made for returns and discounts based on quarterly review of historical rates of returns and expected discounts to be taken. The carrying amount of accounts receivable is reduced, if needed, by a valuation allowance that reflects management s best estimate of the amounts that will not be collected. Management individually reviews all accounts receivable balances that exceed thirty days from the invoice date, and based on an assessment of current creditworthiness, estimates the portion, if any, of the balance that may not be collected. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation based on its assessment of the current status of the individual accounts. Balances that remain outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to trade accounts receivable. Changes in the valuation allowance have not been material to the financial statements. Recoveries of trade receivables previously written off are recorded when received. Due to the nature of our business and our association with large national corporations, our collection of receivables has stayed at a constant level with very few uncollectible accounts.

Buildings and Equipment

Property additions and betterments include capitalized interest and acquisition, construction and administrative costs allocable to construction projects and property purchases. Provision for depreciation of buildings and equipment is provided on a straight-line basis over the estimated useful lives of the assets. Gains or losses on sales or other dispositions

of property are credited or charged to income in the period incurred. Repairs and maintenance costs are charged to income in the period incurred, unless it is determined that the useful life of the respective asset has been extended.

We account for the impairment or disposal of long-lived assets in accordance with the provisions of the Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). SFAS 144 requires an assessment of the recoverability of our investment in long-lived assets to be held and used in operations whenever events or circumstances indicate that their carrying amounts may not be recoverable. Such assessment requires that the future cash flows associated with the long-lived assets be estimated over their remaining useful lives. An impairment loss may be required when the future cash flows are less than the carrying value of such assets.

Revenue Recognition

The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements* (SAB 104). Under SAB 104, revenue is recognized when the title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, delivery has occurred or services have been rendered, the sales price is determinable and collectibility is reasonably assured. The Company typically recognizes revenue at the time of shipment or segregated and billed under a bill and hold agreement. The terms of this agreement qualify for revenue recognition under SAB 104. Sales are recorded net of discounts, rebates, and returns.

Estimates of expected sales discounts are calculated by applying the appropriate sales discount rate to all unpaid invoices that are eligible for the discount. The Company s sales prices are determinable given that the Company s sales discount rates are fixed and given the predictability with which customers take sales discounts.

Contractual Obligations

The following table represents our contractual obligations outstanding as of December 31, 2007:

	Payments Due by Period				
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Long-term debt and capital lease obligations	$36,311,249	$9,806,985	$5,470,339	$3,963,925	$17,070,000
Operating leases	12,337,256	2,873,535	4,378,243	3,323,289	1,762,189
Total	$48,648,505	$12,680,520	$9,848,582	$7,287,214	$18,832,189

Our waste wood and scrap polyethylene supply contracts have varying terms and pricing structures. The contracts generally obligate us to take whatever waste the supplier generates as long as the waste meets our standards. Pricing for these contracts can generally be renegotiated every twelve months, however, so determining our precise future liability is not reasonably estimable.

In July 2006, AERT entered into a lease contract whereby it has agreed to lease up to $3 million of equipment for seven years. Lease payments will begin in April 2008. Until that time, interim interest payments are being made on the amount of equipment subject to the lease that has been purchased by the leasing company, which totaled approximately $2.8 million at December 31, 2007. The lease payments are not included in the table above due to the uncertainty of the commencement of those payments.

Uncertainties, Issues and Risks

There are many factors that could adversely affect AERT s business and results of operations. These factors include, but are not limited to, general economic conditions, decline in demand for our products, business or industry changes, critical accounting policies, government rules and regulations, environmental concerns, litigation, new products / product transition, product obsolescence, competition, acts of war, terrorism, public health issues, concentration of customer base, loss of a significant customer, availability of raw material (plastic) at a reasonable price, management s failure to execute effectively, inability to obtain adequate financing (i.e. working capital), equipment breakdowns, low stock price, and fluctuations in quarterly performance.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

We have no material exposures relating to our long-term debt, as most of our long-term debt bears interest at fixed rates. We depend on the market for favorable long-term mortgage rates to help generate sales of our product for use in the residential construction industry. Should mortgage rates increase substantially, our business could be impacted by a reduction in the residential construction industry. Important raw materials that we purchase are recycled plastic and wood fiber, which are subject to price fluctuations. We attempt to limit the impact of price increases on these materials by negotiating with each supplier on a term basis.

Forward-looking Information

An investment in our securities involves a high degree of risk. Prior to making an investment, prospective investors should carefully consider the following factors, among others, and seek professional advice. In addition, this Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Such forward-looking statements, which are often identified by words such as believes , anticipates , expects , estimates , should , may , will and similar expressions, represent our expectati beliefs concerning future events. Numerous assumptions, risks, and uncertainties could cause actual results to differ materially from the results discussed in the forward-looking statements. Prospective purchasers of our securities should carefully consider the information contained herein or in the documents incorporated herein by reference.

The foregoing discussion contains certain estimates, predictions, projections and other forward-looking statements (within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934) that involve various risks and uncertainties. While these forward-looking statements, and any assumptions upon which they are based, are made in good faith and reflect management s current judgment regarding the direction of the business, actual results will almost always vary, sometimes materially, from any estimates, predictions, projections, or other future performance suggested herein. Some important factors (but not necessarily all factors) that could affect the sales volumes, growth strategies, future profitability and operating results, or that otherwise could cause actual results to differ materially from those expressed in any forward-looking statement include the following: market, political or other forces affecting the pricing and availability of plastics and other raw materials; accidents or other unscheduled shutdowns affecting us, our suppliers or their customers plants, machinery, or equipment; competition from products and services offered by other enterprises; our ability to refinance short-term indebtedness; state and federal environmental, economic, safety and other policies and regulations, any changes therein, and any legal or regulatory delays or other factors beyond our control; execution of planned capital projects; weather conditions affecting our operations or the areas in which our products are marketed; adverse rulings, judgments, or settlements in litigation or other legal matters. We undertake no obligation to publicly release the result of any revisions to any such forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Item 8. Financial Statements and Supplementary Data.

Summary Quarterly Financial Data

	2006				2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	$27,665,249	$28,105,770	$20,800,859	$21,268,248	$22,367,040	$25,342,796	$24,797,778	$ 9,702,349
Gross margin	5,954,316	8,480,538	4,132,310	1,677,997	2,838,452	3,989,802	2,065,163	(1,024,055)
Net income (loss)	905,942	1,723,097	(305,595)	(518,922)	(1,171,659)	(383,919)	(1,529,444)	(6,432,138)
Income (loss) per share (Basic)	$ 0.02	$ 0.04	$ (0.01)	$ (0.01)	$ (0.03)	$ (0.01)	$ (0.03)	$ (0.13)
Income (loss) per share (Diluted)	$ 0.02	$ 0.04	$ (0.01)	$ (0.01)	$ (0.03)	$ (0.01)	$ (0.03)	$ (0.13)

The financial statements portion of this item is submitted in a separate section of this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Our management, with the participation of our Chief Executive Officer, who is our principal executive officer, our Chief Operating Officer, and our Senior Vice President and Chief Financial Officer, who is our principal financial officer, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of December 31, 2007. Based upon this evaluation, our Chief Executive Officer, our Chief Operating Officer, and our Chief Financial Officer concluded that, as a result of material weaknesses in our internal control over financial reporting as of December 31, 2007 described below under Management s Report on Internal Control Over Financial Reporting, our disclosure controls and procedures were not effective as of December 31, 2007. We have initiated the implementation of measures to remediate these material weaknesses as described below under Remediation of Material Weakness in Internal Control Over Financial Reporting.

Management s Report on Internal Control Over Financial Reporting

We, as members of the management of Advanced Environmental Recycling Technologies, Inc. (the Company), are responsible for establishing and maintaining adequate internal control over financial reporting. The Company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that

controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

We assessed the Company s internal control over financial reporting as of December 31, 2007, based on criteria for effective internal control over financial reporting established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management identified three material weaknesses (as defined by the Public Company Accounting Oversight Board) as of December 31, 2007.

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First, the Company did not have an adequate process in place to assess potential impairment of fixed assets. Without a formal, periodic assessment process, material overstatements of the net book value of fixed assets could remain undetected. Second, 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 the calculated costs. Without a formally documented, approved costing process, combined with an independent review of the spreadsheet inputs and formulas used to calculate inventory costs, material misstatements of inventory and cost of goods sold could remain undetected. Third, the Company, at the entity level, has not properly allocated resources to ensure that necessary internal controls are implemented and followed throughout the Company. Without the proper allocation of resources and sufficient priority given to internal controls, material misstatements could occur and remain undetected. Accordingly, management has determined that, because of these material weaknesses, the Company did not maintain effective internal control over financial reporting as of December 31, 2007 based on the specified criteria.

/s/ JOE G. BROOKS
Joe G. Brooks,
Chairman, Chief Executive Officer and President

/s/ STEPHEN W. BROOKS
Stephen W. Brooks,
Vice Chairman and Chief Operating Officer

/s/ ROBERT A. THAYER
Robert A. Thayer,
Senior Vice President and Chief Financial Officer

Remediation of Material Weakness in Internal Control Over Financial Reporting

The Company is in the process of developing systems and procedures to remediate each of the material weaknesses identified in Management s assessment of internal controls as of December 31, 2007. Management believes that these new procedures, in combination with the implementation of a new enterprise resource planning system now underway, will provide controls sufficient to identify and prevent material misstatements in the Company s financial statements.

Changes in Internal Control Over Financial Reporting

Other than the matters described in this Item 9A under Remediation of Material Weakness in Internal Control Over Financial Reporting, during the fourth quarter ended December 31, 2007, there have been no changes in our internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The directors and executive officers of the Company as of December 31, 2007, are as follows:

Name	Age	Position
Joe G. Brooks	52	Chairman, chief executive officer and president
Stephen W. Brooks	51	Vice chairman and chief operating officer
Marjorie S. Brooks	72	Secretary, treasurer and director
J. Douglas Brooks	48	Senior vice president
Alford Drinkwater	56	Senior vice president
Jim Precht	62	Senior vice president sales and marketing
Robert A. Thayer	56	Senior vice president and chief financial officer
Eric E. Barnes	34	Chief accounting officer and controller
Jerry B. Burkett	51	Director
Edward P. Carda	67	Director
Melinda Davis	65	Director
Tim W. Kizer	42	Director
Peter S. Lau	54	Director
Sal Miwa	51	Director
Jim Robason	70	Director
Michael M. Tull	53	Director

The Company s board of directors elected **Joe G. Brooks** as its chairman and the Company s co-chief executive officer in December 1998, and he has served as president since February 2000. In July 2005, Mr. Brooks became chief executive officer. Mr. Brooks has served as president or in other executive office capacities and has been a director since the Company s inception in December 1988, including service as chairman and CEO from inception until August 1993. He was a member of Clean Texas 2000, appointed by then Governor George W. Bush in 1995. Mr. Brooks is a listed inventor on 13 of the Company s patents with additional patents pending, and is a founder of AERT.

The Company s board of directors elected **Stephen W. Brooks** as co-chief executive officer in December 1998 until July 2005 when he became vice chairman and chief operating officer. Mr. Brooks has served as its chief executive officer and has been a director since January 1996. Mr. Brooks has served as CEO and chairman of the board of Razorback Farms, Inc. from January 1996 to the present. Razorback Farms is a Springdale, Arkansas based firm that specializes in vegetables processing. Mr. Brooks also serves on the board of the Ozark Food Processors Association.

Marjorie S. Brooks has been secretary, treasurer and a director since the Company s inception in December 1988. Mrs. Brooks has served as secretary and treasurer of Brooks Investment Company, a holding company for the Brooks family investments, for more than thirty years.

J. Douglas Brooks has served as executive vice-president from inception to September 2003, has been in charge of raw material sourcing and strategic relationships since 1998, and has been a senior vice president since September 2003. Mr. Brooks was vice-president of plastics from 1995 through 1998, was previously project manager for AERT s polyethylene recycling program with The Dow Chemical Company, and is a joint inventor on several of AERT s process patents for recycling polyethylene film for composites.

Robert A. Thayer was named by the board of directors to succeed Edward J. Lysen as chief financial officer in September 2005, at which time he was also named as a senior vice president. Mr. Thayer has submitted his resignation effective April 11, 2008 in order to take a new position. From October 2002 until September 2005, Mr. Thayer served as the assistant to AERT chairman Joe G. Brooks, during which time he had executive assignments in

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all aspects of AERT s business including finance, operations, and administration. From January 1997 to October 2002, Mr. Thayer was a principal at Madison Research, Denison, Texas where he conducted independent financial research under contract to banks and financial publishers. From January 2001 to July 2002 he also served as Vice President of Finance for Asia Teletech Company, Ltd., a Thailand headquartered voice-over-internet company where he was responsible for raising the company s startup capital. Prior to 1997, Mr. Thayer spent twenty-one years in the software and investment banking industries with financial, systems and executive responsibilities. He received a BA in Economics from the University of Colorado and studied graduate economics at the University of Wisconsin, Madison. Mr. Thayer is a Chartered Financial Analyst.

Alford Drinkwater has served as senior vice president of logistics, laboratories, and plastic operations since September 2003. Prior to joining the Company in May 2000, Mr. Drinkwater had been the Assistant Director for the Established Industries Division of the Arkansas Department of Economic Development and was on the Advocacy Team from November 1988 until January 2000. From September 1986 until July 1988, he owned and operated Town and Country Waste Services, Inc. a waste services company engaging in the development of waste recycling, energy recovery, and disposal systems. From April 1981 until January 1987, Mr. Drinkwater was the Resource Recovery Manager for Metropolitan Trust Company, and was primarily involved in waste-to-energy systems development. From July 1974 until April 1981, Mr. Drinkwater worked for the State of Arkansas as Assistant to the Chief of the Solid Waste Control Division of the Arkansas Department of Pollution Control & Ecology and as the Manager of the Biomass and Resource Recovery Program of the Arkansas Department of Energy.

Jim Precht served as executive vice-president of sales and marketing for the Company since February 2001, and as senior vice president since September 2003. Mr. Precht was formerly general manager of Weyerhaeuser Building Materials Pittsburgh Customer Service Center with 32-years of industry experience.

Eric E. Barnes, who the board of directors appointed as chief accounting officer in September 2005, also heads up the AERT accounting and control team. Mr. Barnes joined AERT s accounting department in November 1997 after graduating from the University of Arkansas with a BS in Accounting and an MA in Economics. He was named AERT s controller in January 2000. Mr. Barnes is a Certified Public Accountant.

Jerry B. Burkett has served on the board of directors of the Company since May 1993. Mr. Burkett has been a rice and grain farmer since 1979 and has been a principal in other closely held businesses. He is the past president of the Arkansas County Farm Bureau. In April 2002, Mr. Burkett was elected to serve as a director of the Ag Heritage Farm Credit Services board.

Edward P. Carda was elected to the board of directors in July 2005. Mr. Carda began his 37-year business career with Weyerhaeuser Company in June 1967, ending with his retirement in December 2003. While at Weyerhaeuser, he served in various management positions, including statutory reporting, heading large accounting departments, interacting with external and internal auditors and all types of management. Mr. Carda spent the last 10 years of his career as the business controller for the distribution business of Weyerhaeuser. While in this capacity, he received many awards for his performance for profit and working capital improvement initiatives. Mr. Carda attended the University of Montana and graduated with a degree in accounting. He has served for 25 years on the board of directors of the Woodstone Credit Union in Federal Way, Washington and is currently its Vice Chairman. He also serves on the credit union s audit committee.

Melinda Davis has served on the board of directors since July 2001. From December 2000 to the present, Ms. Davis has provided professional consulting services in the areas of financial management and cost accounting for manufacturing operations. Ms. Davis retired as senior vice-president and treasurer from Allen Canning Co. in December 2000, after serving for 39 years in various accounting and financial management positions.

Tim W. Kizer was elected to the board of directors in July 2005. Since December 2004, Mr. Kizer has served as president and partner of Bentonville Global Associates, a global consultancy firm specializing in collaborative commerce.

Mr. Kizer is executive director of the *Doing Business in Bentonville Series* seminar level program series in Bentonville Arkansas. From April 2001 to December 2004, Mr. Kizer was director of the Center for Management and Executive Development and the Donald W. Reynolds Center for Enterprise Development, Sam M. Walton College of Business, University of Arkansas. From January 2000 to April 2001, Mr. Kizer was managing director of Information Technology Research Center, Sam M. Walton College of Business, University of Arkansas. Mr. Kizer was a business and industry specialist for the Division of Continuing Education at the University of Arkansas from October 1996 until January 2000. He has a BA from the University of Louisville and is a member of the Board of Advisors of RFID Global Solution in Bentonville, Arkansas.

Peter S. Lau has served on the board of directors since July 2007. Mr. Lau is a co-founder and owner of Greenstone Holdings, a boutique investment banking firm in New York City founded in 2001. Previously, he was Senior Managing Director of Corporate Finance for American Frontier, and Managing Director of Corporate Finance at Ridgewood Capital. Mr. Lau started his career as a CPA with Deloitte Touche, and was later employed by Squibb Corporation. Mr. Lau holds a Bachelor of Science in Business Administration and an MS in Accounting from the University of Hartford.

Sal Miwa has been an outside director of the Company since January 1994. He served as chairman of the board between December 1995 and December 1998, and as vice chairman from December 1998 through July 2005. From January 2005 to present, Mr. Miwa has been chairman of Greenstone Holdings, Inc.(OTC GSHG), a chemical technology company located in New York City primarily serving the building and construction industry. From July 2004 to December 2005, he was CEO of Greenstone Inc. of Delaware, a predecessor of Greenstone Holdings, Inc. From April 2000 to June 2004, he was COO and director of RealRead Inc., an online document service company. For more than 20 years Mr. Miwa has been engaged in various international businesses and serves on boards of several closely held family businesses around the world. He received his master s degree in Aerospace Engineering from the Massachusetts Institute of Technology in 1981.

Jim Robason has served on the board of directors since July 2003. Since January 2005, Mr. Robason has been a consultant to and supervisor of the Company s plant operations on an interim basis. Mr. Robason joined Allen Canning Co. in 1967. Mr. Robason served as senior vice-president-operations of Allen Canning Co. from 1974 until his retirement in 2002. As senior vice-president of operations with Allen Canning Co., he was responsible for the operation of twelve plants with plant managers and raw product procurement managers, as well as special projects engineering, reporting to him. He has a vast amount of knowledge in all phases of manufacturing including infrastructure, building, equipment, and engineering; with a focus on the full production arena from product procurement through the production process. Mr. Robason is a graduate of West Texas State University. He has served on Allen Canning s executive committee and profit sharing/retirement plan committee in addition to his operations responsibilities.

Michael M. Tull has served on the board of directors of the Company since December 1998. Mr. Tull has served since 1990 as the president and majority owner of Tull Sales Corporation, a manufacturer s representative company, which professionally represents eight manufacturing companies and is responsible for the sales and marketing of those companies window and door related components in the southeastern United States. Mr. Tull serves on boards of several closely held family businesses. Additionally, he is a board of director member of Greenstone, Inc. and the National Wild Turkey Federation, which is one of the largest North American conservation organizations.

Joe G. Brooks, Stephen W. Brooks, and J. Douglas Brooks are brothers and sons of Marjorie S. Brooks. There are no other familial relationships between the current directors and executive officers.

Each of the Company s directors has been elected to serve until the next annual meeting of stockholders or until their successors are elected and qualified. Officers serve at the discretion of the Board of Directors.

The audit committee of the board of directors consists of outside directors: Edward P. Carda (chairman), Melinda Davis, Peter S. Lau, and Jerry B. Burkett. The audit committee is directly responsible for the engagement of the Company s independent auditors and is responsible for approving the services performed by the Company s independent auditors and for reviewing and evaluating the Company s accounting principles and its system of internal accounting controls. The board of directors has determined that Edward P. Carda qualifies as an audit committee financial expert; as such term is defined in rules of the SEC implementing requirements of the Sarbanes-Oxley Act of 2002. In addition, Edward P. Carda, and the other members of the audit committee are independent, as that term is defined under the listing standards of the National Association of Securities Dealers.

The compensation committee consists of Edward P. Carda (chairman), Sal Miwa, Jim Robason, and Tim Kizer. The compensation committee establishes and administers the Company s compensation and equity incentive plans on behalf of the board of directors and approves restricted stock grants thereunder.

The corporate governance and nominating committee consists of Sal Miwa (chairman), Linda Davis, Jerry Burkett, and Ed Carda. The nominating committee evaluates the efforts of AERT and its board of directors to maintain effective corporate governance practices. The committee identifies candidates for election to the board of directors.

The company also maintains a legal affairs committee consisting of Tim Kizer (chairman), Sal Miwa, and Peter Lau, and a capital expenditure committee consisting of Peter Lau (chairman), Steve Brooks, Edward Carda, and Jim Robason.

Code of Ethics

We adopted a Code of Business Conduct and Ethics applicable to all our directors and associates, including our chief executive officer, chief operating officer, chief financial officer and principal accounting officer or controller, which is a code of ethics as defined by applicable rules of the SEC. This code has been filed with the SEC as an exhibit to our Form 10-K for the fiscal year ended December 31, 2003, and is publicly available on our website at www.aertinc.com. A copy may also be obtained upon written request to our secretary, Marjorie S. Brooks, Post Office Box 1237, Springdale, Arkansas 72765. If we make any amendments to this code other than technical, administrative or other non-substantive amendments or grant any waivers, including implicit waivers, from a provision of this code that applies to our chief executive officer, chief financial officer or principal accounting officer or controller and relates to an element of the SEC s code of ethics definition, we will disclose the nature of the amendment or waiver, its effective date and to whom it applies on our website or in a report on Form 8-K filed with the SEC.

Compliance with Section 16(a) of the Exchange Act

Section 16(a) of the Securities Exchange Act of 1934 requires AERT s executive officers and directors, and persons who own more than ten-percent of a registered class of the Company s securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission and National Association of Securities Dealers. Officers, directors and greater than ten-percent shareholders are required by SEC regulation to furnish the Company with copies of all forms filed pursuant to Section 16(a). Based on a review of the copies of such forms received by it and written representations from certain reporting persons that no Forms 4 or Forms 5 were required for those persons, the Company believes that during the fiscal year ended December 31, 2007; all Section 16(a) filing requirements were met.

Item 11. Executive Compensation.

The information required by Item 11 is incorporated herein by reference to the Company s definitive proxy statement for its 2008 annual meeting of stockholders.

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Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by Item 12 is incorporated herein by reference to the Company s definitive proxy statement for its 2008 annual meeting of stockholders.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by Item 13 is incorporated herein by reference to the Company s definitive proxy statement for its 2008 annual meeting of stockholders.

Item 14. Principal Accountant Fees and Services.

The information required by Item 14 is incorporated herein by reference to the Company s definitive proxy statement for its 2008 annual meeting of stockholders.

Part IV

Item 15. Exhibits and Financial Statement Schedules.

(a1) and (a2). The Financial Statements listed in the accompanying Index to Financial Statements are filed as part of this report and such Index is hereby incorporated by reference. All schedules for which provision is made in the applicable accounting regulation on the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

(a3) and (c). The exhibits listed in the accompanying Index to Exhibits are filed or incorporated by reference as part of this report and such Index is hereby incorporated by reference.

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SIGNATURES

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

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

/s/ JOE G. BROOKS
Joe G. Brooks,
Chairman, Chief Executive Officer and President (principal executive officer)

/s/ STEPHEN W. BROOKS
Stephen W. Brooks,
Vice Chairman and Chief Operating Officer

/s/ ROBERT A. THAYER
Robert A. Thayer,
Senior Vice President and Chief Financial Officer (principal financial officer)

/s/ ERIC E. BARNES
Eric E. Barnes,
Chief Accounting Officer and Controller (principal accounting officer)

Date: April 7, 2008

POWER OF ATTORNEY

The undersigned directors and officers of Advanced Environmental Recycling Technologies, Inc. hereby constitute and appoint Joe G. Brooks our true and lawful attorney-in-fact and agent with full power to execute in our name and behalf in the capacities indicated below any and all amendments to this report on Form 10-K to be filed with the Securities and Exchange Commission and hereby ratify and confirm all that such attorney-in-fact and agent shall lawfully do or cause to be done by virtue thereof.

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

Signature	Title	Date
/s/ JOE G. BROOKS Joe G. Brooks	Chairman, Chief Executive Officer and President	April 7, 2008
/s/ STEPHEN W. BROOKS Stephen W. Brooks	Vice Chairman and Chief Operating Officer	April 7, 2008

/s/ MARJORIE S. BROOKS	Secretary, Treasurer and Director	April 7, 2008
Marjorie S. Brooks		
/s/ JERRY B. BURKETT	Director	April 7, 2008
Jerry B. Burkett		
/s/ EDWARD P. CARDA	Director	April 7, 2008
Edward P. Carda		
/s/ MELINDA DAVIS	Director	April 7, 2008
Melinda Davis		

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Signature	Title	Date
/s/ TIM W. KIZER	Director	April 7, 2008
Tim W. Kizer		
/s/ PETER S. LAU	Director	April 7, 2008
Peter S. Lau		

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Advanced Environmental Recycling Technologies, Inc.

We have audited the balance sheets of Advanced Environmental Recycling Technologies, Inc. as of December 31, 2007 and 2006, and the related statements of operations, stockholders equity and cash flows for each of the years in the three-year period ended December 31, 2007. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Advanced Environmental Recycling Technologies, Inc. as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Advanced Environmental Recycling Technologies, Inc s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our report dated April 7, 2008 expressed an opinion that Advanced Environmental Recycling Technologies, Inc. had not maintained effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by COSO.

/s/ TULLIUS TAYLOR SARTAIN & SARTAIN LLP

Fayetteville, AR
April 7, 2008

To the Board of Directors and Stockholders of
Advanced Environmental Recycling Technologies, Inc.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have audited Advanced Environmental Recycling Technologies, Inc. s (the Company s) internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

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

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management s assessment: 1) the Company did not have a process in place to assess potential impairment of fixed assets. Without a formal, periodic assessment process, material overstatements of the net book value of fixed assets could remain undetected. 2) 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 the calculated costs. Without a formally documented, approved costing process, combined with an independent review of the spreadsheet inputs and formulas used to calculate inventory costs, material misstatements of inventory and cost of goods sold could remain undetected. 3) the Company, at the entity level, has not properly allocated resources to ensure that necessary internal controls are implemented and followed throughout the Company. Without the proper allocation of resources and sufficient priority given to internal controls, material misstatements could occur and remain undetected. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 financial statements, and this report does not affect our report dated April 7, 2008 on those financial statements.

In our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee

of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets as of December 31, 2007 and 2006, and the related statements of operations, stockholders equity and cash flows for each of the years in the three-year period ended December 31, 2007 of Advanced Environmental Recycling Technologies, Inc. and our report dated April 7, 2008 expressed an unqualified opinion.

/s/ TULLIUS TAYLOR SARTAIN & SARTAIN LLP

Fayetteville, AR
April 7, 2008

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.
Balance Sheets

	December 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,716,481	$ 2,164,532
Restricted cash	11,461,950	787,191
Restricted certificate of deposit	871,468	
Trade accounts receivable, net of allowance of $1,162,500 at December 31, 2007 and $374,894 at December 31, 2006	640,668	3,789,302
Other accounts receivable	63,453	760,970
Inventories	23,622,586	14,515,845
Prepaid expenses	892,462	1,018,657
Deferred tax asset		1,163,017
Total current assets	39,269,068	24,199,514
Land, buildings and equipment:		
Land	1,988,638	1,988,638
Buildings and leasehold improvements	10,008,257	5,979,223
Machinery and equipment	51,690,169	39,475,682
Transportation equipment	1,148,046	1,243,556
Office equipment	1,169,213	801,231
Construction in progress	4,218,303	14,762,153
Total land, buildings and equipment	70,222,626	64,250,483
Less accumulated depreciation	31,380,005	26,728,540
Net land, buildings and equipment	38,842,621	37,521,943
Other assets:		
Deferred tax asset	8,851,412	4,293,912
Debt issuance costs, net of accumulated amortization of $1,052,949 at December 31, 2007 and $790,532 at December 31, 2006	3,042,645	2,814,390
Debt service reserve fund	3,391,500	2,040,000
Restricted certificate of deposit		829,961
Other assets, net of accumulated amortization of $421,310 at December 31, 2007 and $392,736 at December 31, 2006	361,557	350,246
Total other assets	15,647,114	10,328,509
Total assets	$ 93,758,803	$ 72,049,966

The accompanying notes are an integral part of these financial statements.

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.
Balance Sheets

	December 31, 2007	December 31, 2006
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable trade	$ 9,274,134	$ 10,861,648
Accounts payable related parties	350,882	494,831
Current maturities of long-term debt	9,582,145	1,580,357
Current maturities of capital lease obligations	224,840	93,255
Accrued payroll expense	553,376	575,782
Litigation loss payable	655,769	655,769
Other accrued liabilities	3,712,700	1,933,821
Working capital line of credit	12,303,378	10,060,000
Notes payable related parties		1,000,000
Notes payable other	385,229	410,181
Total current liabilities	37,042,453	27,665,644
Long-term debt, less current maturities	25,707,959	16,803,644
Capital lease obligations, less current maturities	796,305	24,073
	26,504,264	16,827,717
Accrued dividends on convertible preferred stock	136,957	
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $.01 par value; 5,000,000 shares authorized, 757,576 shares issued and outstanding at December 31, 2007	7,576	
Class A common stock, $.01 par value; 75,000,000 shares authorized; 46,314,250 and 43,041,164 shares issued and outstanding at December 31, 2007 and 2006, respectively	463,143	430,412
Class B convertible common stock, $.01 par value; 7,500,000 shares authorized; 1,465,530 shares issued and outstanding at December 31, 2007 and 2006	14,655	14,655
Warrants outstanding; 3,787,880 at December 31, 2007 and 4,606,132 at December 31, 2006	1,533,578	2,519,389
Additional paid-in capital	50,872,462	37,891,274
Accumulated deficit	(22,816,285)	(13,299,125)
Total stockholders equity	30,075,129	27,556,605
Total liabilities and stockholders equity	$ 93,758,803	$ 72,049,966

The accompanying notes are an integral part of these financial statements.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.
STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2007	2006	2005
Net sales	$ 82,209,963	$ 97,840,126	$ 87,312,560
Cost of goods sold	74,340,601	77,594,965	66,389,964
Gross margin	7,869,362	20,245,161	20,922,596
Selling and administrative costs	16,368,725	16,407,400	14,595,854
Research and development	265,881	285,858	110,134
	16,634,606	16,693,258	14,705,988
Operating income (loss)	(8,765,244)	3,551,903	6,216,608
Other income (expense):			
Net litigation contingency			(610,206)
Gain (loss) on disposition of equipment	7,920	58,285	(26,122)
Interest income	183,409	202,724	90,908
Interest expense	(3,956,935)	(2,844,327)	(2,087,818)
Net other expense	(3,765,606)	(2,583,318)	(2,633,238)
Income (loss) before extraordinary item, income taxes and accrued dividends on preferred stock	(12,530,850)	968,585	3,583,370
Preferred stock dividends from beneficial conversion feature	(943,838)		
Accrued dividends on preferred stock	(136,957)		(235,367)
Income (loss) before extraordinary item and income taxes	(13,611,645)	968,585	3,348,003
Income tax benefit	(3,662,082)	(835,937)	(4,449,682)
Income (loss) before extraordinary item	(9,949,563)	1,804,522	7,797,685
Extraordinary gain on involuntary conversion of non-monetary assets due to fire (net of income tax)	432,403		
Net income (loss) applicable to common stock	$ (9,517,160)	$ 1,804,522	$ 7,797,685
Income (loss) per share of common stock before extraordinary item (Basic)	$ (0.21)	$ 0.04	$ 0.22
Income (loss) per share of common stock before extraordinary item (Diluted)	$ (0.21)	$ 0.04	$ 0.19
Extraordinary gain per share of common stock (Basic)	$ 0.01		
Extraordinary gain per share of common stock (Diluted)	$ 0.01		
	$ (0.20)	$ 0.04	$ 0.22

Income (loss) per share of common stock after extraordinary item (Basic)			
Income (loss) per share of common stock after extraordinary item (Diluted)	$ (0.20)	$ 0.04	$ 0.19
Weighted average number of common shares outstanding (Basic)	47,030,850	41,990,150	35,861,060
Weighted average number of common shares outstanding (Diluted)	47,030,850	45,881,498	40,475,244

The accompanying notes are an integral part of these financial statements.

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.
STATEMENTS OF STOCKHOLDERS EQUITY

	Preferred Stock		Class A Common Stock		Class B Common Stock		Warrants Outstanding		Additional Paid-in Capital	Accumulated Deficit	
	Shares	Amount	Shares	Amount	Shares	Amount	Number	Value	Capital	Deficit	
,	$ 2,760	$ 2,760	$ 32,032,123	$ 320,322	$ 1,465,530	$ 14,655	$ 14,890,867	$ 6,917,544	$ 27,376,565	$ (22,901,332)	$
			229,994	2,300					273,700		
s			387,600	3,876					203,200		
f			1,738,946	17,389			(2,016,332)	(1,120,815)	1,389,382		
							(1,379,926)	(784,532)	784,532		
			325,000	3,250			(325,000)	(96,098)	442,223		
			6,564	66			(6,564)	(3,485)	11,296		
f			21,142	211			(21,142)	(8,220)	24,604		
							(42,997)	(13,478)	13,478		
			300,000	3,000			(300,000)	(106,898)	403,898		
f			310,000	3,100			(310,000)	(183,310)	296,460		
							(1,312,664)	(111,289)	111,289		
of	(2,760)	(2,760)	2,300,000	23,000					(20,240)		

n										
									29,976	7,797,685
,			37,651,369	376,514	1,465,530	14,655	9,176,242	4,489,419	31,340,363	(15,103,647)
			195,965	1,960					233,407	
s			741,000	7,410					443,245	
			987,040	9,870			(987,040)	(485,637)	1,077,861	
			2,987,040	29,870			(2,987,040)	(1,167,901)	3,886,107	
			478,750	4,788			(596,030)	(316,492)	711,704	
n										
									198,587	1,804,522
,			43,041,164	430,412	1,465,530	14,655	4,606,132	2,519,389	37,891,274	(13,299,125)
s	757,576	7,576							9,186,044	
							3,787,880	1,533,578	(1,533,578)	

			160,641	1,607					(1,607)		
s			1,333,130	13,331					662,038		
			1,771,792	17,718			(1,771,792)	(1,142,060)	1,958,448		
f			7,523	75			(508,989)	(270,251)	270,176		
f							(1,304,082)	(692,412)	692,412		
							(1,021,269)	(414,666)	414,666		
n									388,751		
									943,838	(9,517,160)	
,	757,576	$ 7,576	46,314,250	$ 463,143	1,465,530	$ 14,655	3,787,880	$ 1,533,578	$ 50,872,462	$ (22,816,285)	$

The accompanying notes are an integral part of these financial statements.

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.
STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2007	**2006**	**2005**
Cash flows from operating activities:			
Net income (loss) applicable to common stock	$ (9,517,160)	$ 1,804,522	$ 7,797,685
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	5,331,206	4,324,913	4,352,445
Preferred stock dividends from beneficial conversion feature	943,838		
Dividends accrued on preferred stock	136,957		235,367
Provisions for returns	787,606		266,793
Deferred tax benefit	(3,662,082)	(822,047)	(4,634,882)
Extraordinary gain on involuntary conversion of non-monetary assets due to fire	(432,403)		
(Gain) loss on disposition of equipment	(7,920)	(58,285)	26,122
(Increase) decrease in other assets	(1,432,889)	(937,889)	16,761
(Increase) decrease in cash restricted for letter of credit and interest costs	(450,067)	(88,157)	42,708
Changes in current assets and current liabilities	(4,792,670)	(6,202,868)	(784,790)
Net cash provided by (used in) operating activities	(13,095,584)	(1,979,811)	7,318,209
Cash flows from investing activities:			
Purchases of land, buildings and equipment	(4,526,559)	(6,841,889)	(5,907,695)
Proceeds from disposition of equipment		17,400	94,596
Insurance proceeds from involuntary conversion of non-monetary assets due to fire	700,000		
Net cash used in investing activities	(3,826,559)	(6,824,489)	(5,813,099)
Cash flows from financing activities:			
Net borrowings on line of credit	2,243,378	10,060,000	
Proceeds from issuance of notes-related party	750,000	3,303,225	1,900,000
Proceeds from issuance of notes other	18,515,000		
Payments on notes-related party	(1,750,000)	(3,050,000)	(1,753,225)
Payments on notes other	(3,150,627)	(2,734,847)	(2,447,524)
Payments on capital lease obligations	(121,390)	(76,916)	
Increase in cash restricted for payment of long-term debt	(10,224,692)	(30,691)	(31,417)
Increase (decrease) in outstanding advances on factored receivables		(2,450,788)	353,235
Debt acquisition costs	(490,672)		(19,821)
Proceeds from preferred stock placement, net	9,193,620		
Proceeds from exercise of stock options and warrants, net	1,509,475	4,200,826	1,163,129
Net cash provided by (used in) financing activities	16,474,092	9,220,809	(835,623)

Increase (decrease) in cash and cash equivalents	(448,051)	416,509	669,487
Cash and cash equivalents, beginning of period	2,164,532	1,748,023	1,078,536
Cash and cash equivalents, end of period	$ 1,716,481	$ 2,164,532	$ 1,748,023

The accompanying notes are an integral part of these financial statements.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.
NOTES TO FINANCIAL STATEMENTS

Note 1: Description of the Company

Advanced Environmental Recycling Technologies, Inc. (AERT) 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. Its products are made from approximately equal amounts of waste wood fiber and reclaimed polyethylene plastics, which 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. The Company s customers are primarily regional and national door manufacturers, Weyerhaeuser, our primary decking customer, and various building product distributors. Its composite building materials are marketed as a substitute for wood and plastic filler materials for standard door components, fascia board, and decking under the trade names LifeCycle®, MoistureShield®, Weyerhaeuser ChoiceDek® Premium, ChoiceDek®, ChoiceDek® Premium Colors and MoistureShield® outdoor decking. The Company operates manufacturing and recycling facilities in Springdale and Lowell, Arkansas. It also operates a warehouse and reload complex in Lowell, Arkansas.

The Company s Junction, Texas manufacturing facility suspended extrusion operations in October 2007. The raw materials department at the facility is working on a new product concept for 2008.

In late 2007, the Company closed its plastic recycling facility in Alexandria, Louisiana, removing its recycling equipment and relocating it to its Lowell, Arkansas recycling facility. Also in 2007, the Company paid out the remainder of its lease for the Alexandria facility, which was set to expire in May 2008.

Note 2: Summary of Significant Accounting Policies

Revenue Recognition Policy

The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements* (SAB 104). Under SAB 104, revenue is recognized when the title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, delivery has occurred or services have been rendered, the sales price is determinable and collectibility is reasonably assured. The Company typically recognizes revenue at the time of shipment or segregated and billed under a bill and hold agreement. The terms of this agreement qualify for revenue recognition under SAB 104. Sales are recorded net of discounts, rebates, and returns, which were $3,516,318 in 2007, $2,277,893 in 2006, and $2,211,835 in 2005.

Estimates of expected sales discounts are calculated by applying the appropriate sales discount rate to all unpaid invoices that are eligible for the discount. The Company s sales prices are determinable given that the Company s sales discount rates are fixed and given the predictability with which customers take sales discounts.

Shipping and Handling

In accordance with Emerging Issues Task Force (EITF) Issue 00-10, *Accounting for Shipping and Handling Fees and Costs*, the Company records shipping fees billed to customers in net sales and records the related expenses in cost of goods sold.

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Operating Costs

The cost of goods sold line item in the Company s statements of operations includes costs associated with the manufacture of our products, such as labor, depreciation, repair and maintenance, utilities, leases, and raw materials, including the costs of raw material delivery, warehousing and other distribution related costs. The selling and administrative costs line item in the Company s statements of operations includes costs associated with sales, marketing, and support activities like accounting and information technology. The types of costs incurred in those areas include labor, advertising, travel, commissions, outside professional services, leases and depreciation.

Statements of Cash Flows

In order to determine net cash provided by (used in) operating activities, net income (loss) has been adjusted by, among other things, changes in current assets and current liabilities, excluding changes in cash, current maturities of long-term debt and current notes payable. Those changes, shown as an (increase) decrease in current assets and an increase (decrease) in current liabilities, are as follows:

	Year Ended December 31,		
	2007	**2006**	**2005**
Receivables	$ 3,058,545	$ (1,556,571)	$ (705,900)
Inventories	(9,106,741)	(4,767,102)	(2,355,905)
Prepaid expenses and other	1,654,972	1,257,433	1,219,421
Accounts payable trade and related parties	(2,155,919)	(1,265,529)	835,910
Accrued income taxes		(116,754)	117,200
Accrued liabilities	1,756,473	245,655	104,484
	$ (4,792,670)	$ (6,202,868)	$ (784,790)
Cash paid for interest	$ 3,380,690	$ 2,573,679	$ 2,458,323
Cash paid for income taxes	$	$ 285,824	$ 68,000

Supplemental Disclosures of Non-cash Investing and Financing Activities

	Year Ended December 31,		
	2007	**2006**	**2005**
Notes payable for financing of insurance policies	$1,528,777	$1,569,789	$1,339,084
Accounts / notes payable for equipment	1,437,664	3,409,523	3,936,561
Accrued dividends on preferred stock paid with Class A common stock		235,367	276,000

Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments, those with a maturity of three months or less when purchased, to be cash equivalents. At December 31, 2007 and 2006, restricted cash included $859,367, and $523,194, respectively, that was restricted for payment of principal and interest on the Company s bonds payable. At December 31, 2007, restricted cash included $10,353,930 that was restricted for payment of construction and equipment costs at our planned Watts, Oklahoma plastic recycling facility (see Note 5: Notes Payable and Long-term Debt). Additionally,

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restricted cash at December 31, 2007 and 2006 included $248,653 and $263,998, respectively, which served as collateral for letters of credit with respect to purchases on credit from certain vendors.

Buildings and Equipment

Buildings and equipment are stated at cost and depreciated over the estimated useful life of each asset using the straight-line method. Estimated useful lives are: buildings 15 to 30 years, leasehold improvements 2 to 6 years, transportation equipment 3 to 5 years, office equipment 3 to 6 years and machinery and equipment 3 to 10 years. Depreciation expense recognized by the Company for the years ended December 31, 2007, 2006 and 2005 was approximately $4.7 million, $3.9 million, and $4.1 million, respectively.

Gains or losses on sales or other dispositions of property are credited or charged to income in the period incurred. Repairs and maintenance costs are charged to income in the period incurred, unless it is determined that the useful life of the respective asset has been extended.

The Company accounts for the impairment or disposal of long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). SFAS 144 requires an assessment of the recoverability of the Company s investment in long-lived assets to be held and used in operations whenever events or circumstances indicate that their carrying amounts may not be recoverable. Such assessment requires that the future cash flows associated with the long-lived assets be estimated over their remaining useful lives. An impairment loss may be required when the future cash flows are less than the carrying value of such assets.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market. Inventories consisted of the following at December 31:

	2007	2006
Parts and supplies	$ 2,423,766	$ 2,007,535
Raw materials	7,182,551	5,072,734
Work in process	3,906,810	3,928,442
Finished goods	10,109,459	3,507,134
	$ 23,622,586	$ 14,515,845

Other Assets

Debt issuance costs are amortized over the term of the related debt. Amortization of debt issuance costs charged to interest expense was $267,476 for 2007 and $241,276 for 2006.

The net costs for the preparation of patent applications of $64,438 and $93,012 as of December 31, 2007 and 2006, respectively, are amortized using the straight-line method over 17 years. Amortization expense for patents was $28,573 for each of 2007 and 2006. The amortization of intangible assets resulted in aggregate expense of $296,049 for 2007 and $269,849 for 2006.

The debt service reserve fund is restricted for the life of the bonds payable (see Note 5: Notes Payable and Long-term Debt) for payment of principal and interest on the bonds in the case the Company is unable to make those payments.

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As a result of the judgment against the Company in the ACS lawsuit (see Note 12: Commitments and Contingencies), the Company purchased a certificate of deposit that was restricted for payment of any final judgment that might have been levied after the appeals process was complete. The certificate of deposit was recorded in the other assets section of the Company s balance sheet at December 31, 2006. In February 2008, the Arkansas Supreme Court rejected our appeal of the case, and the judgment will be paid from the certificate of deposit in 2008. As a result, the Company recorded the certificate of deposit in current assets at December 31, 2007.

As of December 31, the Company had the following amounts related to intangible assets:

	2007		2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Debt issuance costs	$ 4,095,594	$ 1,052,949	$ 3,604,922	$ 790,532
Patents	485,748	421,310	485,748	392,736
	$ 4,581,342	$ 1,474,259	$ 4,090,670	$ 1,183,268

The following table represents the total estimated amortization of intangible assets for the five succeeding years:

	Estimated Amortization
2008	$318,998
2009	314,043
2010	292,762
2011	285,470
2012	285,470

Accounts Receivable

Accounts receivable are uncollateralized customer obligations due under normal trade terms generally requiring payment within thirty days from the invoice date. Trade accounts are stated at the amount management expects to collect from outstanding balances. Delinquency fees are not assessed. Payments of accounts receivable are allocated to the specific invoices identified on the customers remittance advice.

Accounts receivable are carried at original invoice amounts less an estimated reserve made for returns and discounts based on quarterly review of historical rates of returns and expected discounts to be taken. The carrying amount of accounts receivable is reduced, if needed, by a valuation allowance that reflects management s best estimate of the amounts that will not be collected. Management individually reviews all accounts receivable balances that exceed thirty days from invoice date, and based on an assessment of current creditworthiness, estimates the portion, if any, of the balance that will not be collected. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation account based on its assessment of the current status of the individual accounts. Balances that remain outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to trade accounts receivable. Recoveries of trade receivables previously written off are recorded when received.

Earnings Per Share

The Company calculates and discloses earnings per share (EPS) in accordance with SFAS No. 128, *Earnings Per Share* (SFAS 128). SFAS 128 requires dual presentation of basic and diluted EPS on the face of the statements of operations and requires a reconciliation of the numerator and denominator of the basic EPS computation to the numerator

and denominator of the diluted EPS computation. Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

In computing diluted EPS, only potential common shares that are dilutive those that reduce earnings per share or increase loss per share are included. Exercise of options and warrants or conversion of convertible securities is not assumed if the result would be antidilutive, such as when a loss from continuing operations is reported. The control number for determining whether including potential common shares in the diluted EPS computation would be antidilutive is income from continuing operations. As a result, if there is a loss from continuing operations, diluted EPS would be computed in the same manner as basic EPS is computed, even if an entity has net income after adjusting for discontinued operations, an extraordinary item or the cumulative effect of an accounting change. The Company incurred a loss from continuing operations for the year ended December 31, 2007. Therefore, basic EPS and diluted EPS are computed in the same manner for that year.

	2007			
	Before Extraordinary Item	**After Extraordinary Item**	**2006**	**2005**
Net income (loss) applicable to common stock (A)	$ (9,949,563)	$ (9,517,160)	$ 1,804,522	$ 7,797,685
Assumed exercise of stock options and warrants			6,231,993	11,160,603
Application of assumed proceeds toward repurchase of stock at average market price			(2,340,645)	(6,546,419)
Net additional shares issuable			3,891,348	4,614,184
Adjustment of shares outstanding:				
Weighted average common shares outstanding	47,030,850	47,030,850	41,990,150	35,861,060
Net additional shares issuable			3,891,348	4,614,184
Adjusted shares outstanding (B)	47,030,850	47,030,850	45,881,498	40,475,244
Net income (loss) per common share Diluted (A) divided by (B)	$ (0.21)	$ (0.20)	$ 0.04	$ 0.19
Antidilutive and/or non-exercisable options	1,521,500	1,521,500	275,000	682,500
Antidilutive and/or non-exercisable warrants	3,787,880	3,787,880	1,021,269	1,021,269

The Company has additional options and warrants that were not included in the calculation of diluted earnings per share for the years ended December 31, 2007, 2006 and 2005, as indicated in the above table. Those options and warrants were antidilutive and/or not exercisable during those periods. Although the above financial instruments were not included due to being antidilutive and/or not exercisable, such financial instruments may become dilutive and would then need to be included in future calculations of diluted EPS.

Concentration Risk

Credit Risk

The Company s revenues are derived principally from Weyerhaeuser, the Company s primary decking customer, regional building materials dealers, and a number of regional and national door and window manufacturers. The Company extends unsecured credit to its customers. The Company s concentration in the building materials industry has the potential to impact its exposure to credit risk because changes in economic or other conditions in the construction

industry may similarly affect the customers. Weyerhaeuser is the only customer from which the Company derived more than 10% of its revenue in 2007, 2006 and 2005. The following table presents sales to Weyerhaeuser and the percentage of gross sales that those sales represent.

	2007	2006	2005
Sales (in millions)	$64.4	$81.1	$68.5
% of total sales	75%	81%	77%

Cash and Cash Equivalents

The Company maintains bank accounts which are insured by the Federal Deposit Insurance Corporation (FDIC) up to $100,000. At times, cash balances may be in excess of the FDIC insurance limit. The Company believes no significant concentrations of risk exist with respect to its cash.

Disclosure about Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument held by the Company:

Current assets and current liabilities The carrying value approximates fair value due to the short maturity of these items.

Long-term debt The fair value of the Company s long-term debt has been estimated by the Company based upon each obligation s characteristics, including remaining maturities, interest rate, credit rating, and collateral and amortization schedule. The carrying amount approximates fair value.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* (SFAS 123R). SFAS 123R is a revision of SFAS 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. This statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions) and requires that cost to be recognized in the financial statements. In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107, which includes interpretations that express views of the SEC staff regarding the interaction between SFAS 123R and certain SEC rules and regulations and provide the staff s views regarding the valuation of share-based payment arrangements for public companies. The Company adopted the provisions of this statement effective January 1, 2006, using the modified prospective method of transition provided in SFAS 123R. Under modified prospective application, this statement applies to new awards and to awards modified, repurchased, or cancelled after the effective date. Compensation cost for the unvested portion of awards at the effective date is to be recognized as the awards vest. The grant-date fair value of those awards is to be used to calculate compensation cost under SFAS 123R. The adoption of SFAS 123R did not have a material effect on the Company s financial statements and related disclosures. In 2005, the Company modified its employee/director equity compensation policies to generally provide restricted stock awards rather than stock options. Restricted stock awards are expensed as earned as a portion of compensation costs.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and

liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Advertising Costs

Advertising costs are charged to expense in the period incurred. Advertising expense was approximately $1,772,249, $1,785,467, and $1,481,000 in 2007, 2006, and 2005, respectively.

Research and Development Costs

Expenditures for research activities relating to product development and improvement are charged to expense as incurred. Such expenditures amounted to $265,881, $285,858, and $110,134 in 2007, 2006, and 2005, respectively.

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). This interpretation 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.* FIN 48 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. The Company adopted the provisions of this statement effective January 1, 2007. The adoption of FIN 48 did not have a material effect on the Company s financial statements and related disclosures.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. The issuance of this standard is meant to increase consistency and comparability in fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS 157 to have a material effect on its financial statements and related disclosures.

In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value, and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS 159 to have a material effect on its financial statements and related disclosures.

In March 2008, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 requires enhanced disclosures about an entity s derivative and hedging activities, including qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008.

Reclassifications

Certain reclassifications have been made to prior years financial statements to conform to the current year presentation. These reclassifications had no effect on the Company s net income.

Note 3: Related Party Transactions

Transfer of Receivables

During the first quarter of 2006, the Company accounted for transfers of receivables, with recourse, to a related party (Brooks Investment Co.) under the guidelines of SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140). This statement provides accounting and reporting standards for, among other things, the transfer and servicing of financial assets, such as transfers of receivables with recourse, and provides standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. Based on the requirements of SFAS 140, the receivables transferred to the related party with recourse were accounted for as a secured borrowing because the Company was not considered to have surrendered control over the transferred assets. The Company discontinued the agreement with Brooks Investment Co. on March 31, 2006.

The terms of the agreement with Brooks Investment Co., controlled by Marjorie S. Brooks, allowed the Company to transfer certain of its trade receivables as collateral, which Brooks Investment Co. deemed acceptable, up to $4.0 million at any one time. Upon acceptance of a transfer of a receivable, Brooks Investment Co. remitted to the Company 85% of the receivable, as defined in the agreement. Upon collection of the receivable, the Company remitted to Brooks Investment Co. 1.25% of the receivable as a factoring charge. The remaining receivable, less interest costs, which were based on the time period over which the receivable was outstanding, was remitted to the Company. The Company indemnified Brooks Investment Co. for any loss arising out of rejections or returns of any merchandise, or any claims asserted by the Company s customers. During 2006 and 2005, the Company transferred an aggregate of approximately $28.6 million and $89.5 million, respectively, in receivables under this agreement, none of which remains to be collected. Costs associated with the factoring agreement of $347,392 and $669,718 were included in selling and administrative costs for the years ended December 31, 2006 and 2005, respectively.

Lease

In December 2007, the Company entered into a 20-year lease for an existing 16 building complex on 60 acres in Adair County, Oklahoma near the town of Watts, for construction of a waste plastic washing, recycling, and reclamation facility. The property is being leased from a corporation controlled by Marjorie S. Brooks, our major shareholder, with payments of .0075 cents per pound of plastic recycled, commencing on January 1, 2009 on a pounds of production, or net throughput of recycled plastic produced, basis with a minimum rent of $1,000.00 per month. The throughput or production rent is due quarterly and is capped throughout the term of the lease not to exceed $450,000 per year.

Beginning in 2011, from January 1 to March 1, 2011 for a 60-day period and every three years thereafter, the company shall have the right to purchase the site and any adjoining property of 891 acres required for the operation of

its facility at fair market value.

Commissions

The Company employs the services of a related party, Tull Sales, Inc., as an outside sales representative. Tull Sales is owned by Michael M. Tull, one of our directors. Commission costs incurred by the Company for services performed by Tull Sales were $679,390 in 2007, $786,971 in 2006, and $677,794 in 2005.

In addition to the related party transactions discussed above, Joe Brooks, our Chairman and CEO, personally guarantees repayment of the Company s automobile loans, which had a balance of $76,888 at December 31, 2007.

At December 31, 2007, accounts payable-related parties included the following amounts:

Sales commissions of $63,501 owed to Tull Sales Co., which is owned by Michael M. Tull, one of our directors,

Loan guarantee fees of $155,268, equipment rental of $27,344 and miscellaneous charges of $70,101 owed to Marjorie S. Brooks, one of our directors, or companies controlled by her, and

Deferred compensation of $20,667 and out-of-pocket expenses of $15,000 owed to Joe G. Brooks

Note 4: Line of Credit

In September 2007, the Company renewed its $15.0 million bank line of credit. The line is a revolving credit facility maturing June 2008, secured by inventory, accounts receivable, chattel paper, general intangibles and other current assets, as well as by fixtures and equipment, and is provided by Liberty Bank of Arkansas at a variable interest rate of prime plus one hundred basis points which was 8.25% at December 31, 2007. The maximum amount that may be drawn on the line at one time is the lesser of $15.0 million and the borrowing base, of which approximately $1.9 million was available to borrow at December 31, 2007. The borrowing base is equal to the sum of approximately 85% of our qualifying accounts receivable, 75% of finished goods inventory and 50% of all other inventory. The full amount of the line is guaranteed as to payment by our largest stockholder, Marjorie Brooks. The credit facility includes debt service coverage ratio, current ratio, and accounts payable and accounts receivable aging 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 Company expects to either renew its line of credit for one year at the June 2008 maturity date, or seek a larger working capital line of credit.

Note 5: Notes Payable and Long-Term Debt

Notes Payable Related Parties

Notes payable to related parties consisted of the following at December 31:	**2007**	**2006**
9.25% note payable to Brooks Investment Company, which is controlled by Marjorie S. Brooks, an officer and director of the Company; unsecured; due on demand; no periodic principal or interest payments required; paid in 2007		$ 1,000,000

Notes Payable Other

Notes payable other, consisted of the following at December 31:	**2007**	**2006**
Various notes payable to finance insurance policies bearing interest at rates of 10.5% and 11.25%; secured by insurance policies; principal and interest payable monthly	$ 385,229	$ 398,181
Other		12,000
	$ 385,229	$ 410,181

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Long-term Debt

Long-term debt, less current maturities consisted of the following at December 31:	2007	2006
8% bonds payable to Bank of Oklahoma; principal payable annually beginning December 15, 2009; interest payable semi-annually; subject to mandatory sinking fund redemption; secured by real estate and improvements, fixed assets, patents and trademarks, inventory, and pledged revenues; maturing on December 15, 2023(a)	$ 13,515,000	
7% bonds payable to Regions Bank; principal payable annually; interest payable semi-annually; subject to mandatory sinking fund redemption; secured by real estate and improvements, fixed assets, patents and trademarks, inventory, pledged revenues, and a personal guarantee on $4 million of the outstanding balance by Marjorie S. Brooks, the major shareholder; maturing on October 1, 2017(a)	11,200,000	12,100,000
10% note payable to Allstate Insurance Company, secured by subordinated interest in the collateral securing the bonds payable; principal and interest due October 1, 2008	5,000,000	
19.75% note payable to Allstate Insurance Company, secured by subordinated interest in the collateral securing the bonds payable; interest payable semiannually; principal due on October 1, 2017	2,600,000	2,600,000
Variable rate note payable bearing interest at the Wall Street Journal prime rate plus 1% (8.25% at December 31, 2007); secured by certain real estate and equipment purchased with proceeds from the note; principal and interest payable monthly; maturing on September 28, 2009	1,900,799	1,925,679
Variable rate note payable bearing interest at LIBOR plus 3.1% (7.6% at December 31, 2007); secured by equipment purchased with proceeds from the note; principal and interest payable monthly; maturing on May 1, 2009	997,416	1,623,092
Other	76,889	135,230
Total	35,290,104	18,384,001
Less current maturities	(9,582,145)	(1,580,357)
Long-term debt, less current maturities	$ 25,707,959	$ 16,803,644

(a) 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 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.

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The aggregate maturities of long-term debt as of December 31, 2007 are as follows:

Year	Amount
2008	$ 9,582,145
2009	3,383,723
2010	1,647,863
2011	1,781,373
2012	1,825,000
Thereafter	17,070,000
	$ 35,290,104

On February 21, 2008, Advanced Environmental Recycling Technologies, Inc. completed a refunding of a prior 2003 industrial development bond obligation. On February 21, 2008, the City of Springdale, Arkansas Industrial Development Refunding Revenue Bonds (Advanced Environmental Recycling Technologies, Inc. Project), Series 2008 (the Series 2008 Bonds) were issued pursuant to an indenture, dated as of February 1, 2008, by and between the City of Springdale, Arkansas, as Issuer , and Bank of Oklahoma, N.A., as Trustee . The proceeds received from the sale of the Series 2008 Bonds were loaned by the Issuer to AERT, pursuant to the terms of a loan agreement, dated as of February 1, 2008, between AERT and the Issuer. The Series 2008 Bonds are special obligations of the Issuer, payable solely from the revenues assigned and pledged by the indenture to secure such payment. Those revenues will include the loan payments required to be made by AERT under the loan agreement.

The Series 2008 Bonds were issued in an aggregate principal amount of $10.61 million, bear interest at a rate of 8% per annum and, subject to sinking fund obligations, mature on December 15, 2023.

Proceeds of the bonds were used, along with other funds of AERT, to refund, pay and discharge the $11.2 million aggregate principal amount of the Issuer s Series 2003 Industrial Development Refunding Revenue Bonds. Pursuant to the loan agreement, AERT will be obligated to make payments on the dates and in the amounts necessary to pay the principal of, premium (if any) and interest on the Series 2008 Bonds when due. The proceeds received from the sale of the Series 2003 Bonds were applied to refund a prior Series 1999 City of Springdale, Arkansas Industrial Development Revenue Bonds, which Series 1999 Bonds were in turn used, along with other funds of AERT, to finance and refinance costs of acquiring, constructing and equipping certain solid waste disposal and related facilities, used in connection with AERT s manufacturing facilities located in Springdale, Arkansas.

At substantially the same time as the issuance of the Series 2003 Bonds, the Company delivered a promissory note (the taxable note) in the principal amount of $2,600,000 and bearing interest at the rate of 19.75%, payable to Allstate Insurance Company, the holder of the Series 2003 Bonds (and now the holder of the Series 2008 Bonds). Proceeds of the Taxable Note were applied to the repayment of certain related-party indebtedness of the Company and to the payment of certain capital improvements of the Company.

As a condition to the purchase of the Series 2008 Bonds by Allstate, the Company was required to make an $800,000 prepayment of the taxable note on the date of issue of the bonds. The remaining $1,800,000 principal balance of the taxable note is due and payable on May 1, 2008. A failure to pay the taxable note when due shall constitute an event of default under the loan agreement. In connection with the issuance of the Series 2008 Bonds, the Company also repaid an approximately $1.0 million loan to Regions Bank, without prepayment penalty.

In May 2007, the Company also entered into a loan arrangement with Allstate Insurance Company, providing a $5,000,000 loan (the Allstate Note), payable on October 1, 2008, and bearing interest a the rate of 10% per annum. The Series 2008 Bonds are secured on a parity with the taxable note and the 2007 Allstate note, and with the Adair County (Oklahoma) Industrial Authority Solid Waste Recovery Facilities Revenue Bonds Series 2007 (the Adair County Bonds), issued on December 19, 2007, in the principal amount of $13,515,000. The proceeds received from the sale of the Adair County Bonds were loaned by the Adair County Industrial Authority to AERT, pursuant to the terms of a loan agreement, dated as of December 1, 2007, between AERT and the Adair County Industrial Authority,

and are being used to develop and complete new recycling facilities located in Watts, Oklahoma, approximately 35 miles east of Springdale, Arkansas.

Note 6: Stockholders Equity

Preferred Stock

Series A, B and C

The Company issued 1,500 Series A preferred shares, 900 Series B preferred shares and 500 Series C preferred shares at a price of $1,000 per share in 1998. Such stock was purchased by the major stockholder, a 5% holder and accredited institutional investors. The preferred stock had an interest premium of 10% per year payable in cash or common stock. The Company converted $235,367 and 276,000 of accrued premiums to common stock in 2006 and 2005, respectively. These transactions are considered non-cash financing activities for statement of cash flow purposes.

On November 7, 2005, the seventh anniversary date of the issuance of the preferred stock, the remaining 2,760 shares of all series of preferred stock were automatically converted into shares of common stock according to the mandatory conversion feature of the preferred stock. The conversion price was $1.20, the lower of the average of the closing bid prices for the common stock for the five trading days immediately preceding the conversion date and the fixed conversion price of $1.20. The preferred stock was originally issued with two classes of warrants, Series X and Y, which can be exercised at $1.20 and $2.50 per share, respectively, as described in the warrants section below.

Series D

On October 29, 2007, the Company sold for $10 million cash (i) an aggregate 757,576 shares of a newly established Series D Convertible Preferred Stock , convertible initially at a conversion price of $1.32, and (ii) accompanying five-year warrants to acquire an aggregate of 3,787,880 shares of common stock at an initial exercise price of $1.38. The Series D preferred stock has an 8% cumulative dividend rate. For the first two quarters following the closing, the Company may pay dividends in additional shares of Series D preferred stock. Beginning in the third quarter following the closing, dividends may be paid in either cash or in shares of common stock, at the option of the Company. Upon any liquidation, dissolution or winding up of the Company, the holders of the Series D preferred stock are entitled to receive a liquidation preference equal to two times the original purchase price plus all accrued but unpaid dividends. In addition to separate protective voting rights as to certain customary matters, the holders of the Series D preferred stock will be entitled to vote on an as-converted basis together with the holders of the Company s common stock on all other matters submitted to a vote of the Company s stockholders.

Beginning 18 months after closing, the Company may cause a mandatory conversion of the Series D preferred stock if there is a currently effective resale registration statement and the closing price of the Company s common stock for the preceding 20-trading day period has been at least 200% of the conversion price and the average daily trading volume for such period has been at least 100,000 shares.

The preferred shares and warrants are subject to a full ratchet anti-dilution adjustment during the initial two-year period following closing in the event, with certain customary exceptions, that the Company issues additional equity securities at a lower per share price, and thereafter are subject to a weighted average anti-dilution adjustment in such circumstances.

The Company intends to seek before July 2008 such stockholder approval as may be required under NASDAQ Capital Market rules for the issuance of underlying common shares upon conversion or exercise, to the extent any such anti-dilution adjustments could cause the issuance of in excess of 19.99% of the currently outstanding number of shares of the Company s common stock at a price below the prevailing price on the date of original issuance. The Company has undertaken not to make any issuances of securities that would cause an anti-dilution adjustment to the Series D preferred stock or warrants unless such stockholder approval has been first obtained. The preferred share designation and the warrants contain blocker provisions prohibiting the conversion of the preferred shares or the exercise of the warrants if as a result an investor or its affiliates would beneficially own in excess of 4.99% of the Company s outstanding common stock. The blocker provision may be waived by the investor upon 61 days prior written notice.

In the event of certain mergers, consolidations or other business combinations to which the Company is a party, the holders of the Series D preferred stock will be entitled at their option to have such preferred stock redeemed at 100% of its stated value plus accrued dividends. In the event of certain specified triggering events such as a lapse of the registration statement, suspension of its listing, deregistration under the Exchange Act, completion of a going private

transaction, failure to comply with certain conversion procedures and timing, or breaches of the Company s representations , covenants and other obligations to the investors, the holders of the Series D preferred stock will be entitled at their option to have such preferred stock redeemed at 120% of the stated value plus accrued dividends. In the event holders elect such a redemption in the case of a major transaction or triggering event, the Company has the option to make the redemption payment in either cash or stock for those redemption events not in its control, valued at the lesser of the conversion price or the then-current 30-day volume-weighted average price of the common stock. The Company could be required to make redemption payments in cash for certain redemption events that are within its control. Also in the event of such a merger, consolidation or business combination, the Company will have the option to redeem the Series D preferred stock at an amount equal to the liquidation preference plus any accrued and unpaid dividends and liquidated damages, if any.

The investors were granted a right of first offer during the 12 months following closing with respect to any proposed issuance by the Company, with certain customary exceptions, of common stock or other debt or equity securities convertible, exercisable or exchangeable for the Company s common stock. The Company agreed not to issue variable-priced equity or variable-priced equity linked securities while the Series D preferred stock remains outstanding.

The Company and the investors also entered into a registration rights agreement under which, among other things, the Company agreed to use its best efforts to (i) file a registration statement with the SEC for the resale of the common stock underlying the Series D preferred stock and the warrants within 30 days following the closing, and (ii) cause such registration statement to become effective within 120 days after closing. If the registration statement is not filed within 30 days after closing or declared effective within 120 days after closing, the Company must pay the investors liquidated damages of 1.5% of the amount invested for an initial 30-day period and 1.0% of the amount invested for each 30-day period thereafter until the registration statement is filed or effective, as the case may be. In addition, for certain delays in processing a trade or the reissuance of stock certificates, the Company could be liable for additional partial liquidated damages of between $10-20 per trading day per $2,000 of securities so delayed, subject to a cap so that such damages will not exceed 1.5% of the stated value of the preferred stock held by the investor affected by such delays during any 30 day period.

The proceeds are being used to pay approximately $ 3.0 million of existing indebtedness, to implement operating and manufacturing efficiencies designed to improve the Company s waste plastic recycling process and allow it to better control its supply costs, for marketing initiatives designed to promote the green building, environmentally-conscious features of its products, and for working capital and other general corporate purposes. The shares and warrants were sold to three private equity firms and certain affiliates that are accredited investors in a private placement exempt from registration under Rule 506 and/or Section 4(2) of the Securities Act. In connection with the issuance of the preferred stock, the Company recorded $943,838 in preferred stock dividends for the beneficial conversion feature of the preferred stock.

Common Stock

The Class A common stock and the Class B common stock are substantially similar in all respects except that the Class B common stock has five votes per share while the Class A common stock has one vote per share. Each share of Class B common stock is convertible at any time at the holder s option to one share of Class A common stock and, except in certain instances, is automatically converted into one share of Class A common stock upon any sale or transfer.

Warrants

The Company has reserved 4,606,132 shares of the Company s Class A common stock for issuance under warrant agreements.

Class C Warrants

In June 1993, 650,000 detachable Class C warrants were issued to Marjorie S. Brooks, an officer and director of the Company, and four other individuals, in connection with the issuance of bridge notes in the amount of $650,000. Each Class C warrant was exercisable into one share of Class A common stock at an exercise price of $1.075 per share. During 1998, the Company received net proceeds of $330,000 from the exercise of 275,000 Class C warrants. One Bonus warrant (described below) was granted to the holder for each warrant exercised. On February 12, 1999, 50,000 Class C warrants expired. The remaining 325,000 Class C warrants were set to expire in June 2003, but the expiration date was extended to June 2005. In June 2005, the remaining 325,000 Class C warrants were exercised for

proceeds of $349,375.

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Class F Warrants

In May 1994, the Company completed a private placement offering at market price to certain bridge note holders and affiliated stockholders, including Marjorie S. Brooks, an officer and director of the Company. As part of the private placement, 3,468,400 shares of Class A common stock, 3,468,400 Class F warrants, and 3,468,400 Class G warrants (see below) were issued. Net offering proceeds of approximately $2,065,000 consisted of $2,020,000 conversion of debt and accrued interest and $45,000 in cash. In 1999, 350,864 Class F warrants were exercised at a price of $0.61 per share, resulting in proceeds of $214,027. The remaining 987,040 Class F warrants were exercised at a price of $0.61 per share resulting in proceeds of $602,094.

Class G Warrants

In 1999, 481,810 Class G warrants were exercised at prices ranging from $0.91 to $0.92 per share, resulting in proceeds of $441,956. The remaining 2,987,040 warrants were exercised at a price of $0.92 per share, resulting in proceeds of $2,748,077.

Class H Warrants

In 1995, in connection with a note payable to Marjorie S. Brooks and accounts payable to a company controlled by her (see Note 3), the Company s Board of Directors authorized the issuance of up to 2,000,000 Class H warrants on a one-for-one basis for each dollar advanced under the agreement and having an exercise price equal to the per share market value of the Company s Class A common stock on the date of such advances. The warrants were exercisable at prices from $0.39 to $0.49 per share of Class A common stock for each Class H warrant exercised. In 2000, 228,208 shares of Class H warrants were exercised at prices ranging from $0.39 to $0.49 per share, resulting in proceeds of $100,000. In 2007, the remaining 1,771,792 Class H warrants were exercised at an average price of $0.47 per share, resulting in proceeds of $834,106.

Class I Warrants

In June 1996, the Company completed an offering to qualified foreign investors under Regulation S of the Securities Act of 1933 with the issuance of 1,666,893 shares of Class A common stock. Net offering proceeds consisted of $1,146,000 in cash. As part of the offering, the Company issued 242,878 Class I warrants to the stock placement distributor. The Class I warrants were to expire three years from the date of issue and were exercisable at prices ranging from $0.9375 to $1.125 per share of Class A common stock for each Class I warrant exercised. In May 1997, an additional 150,466 Class I warrants were issued in connection with the December 1996 Regulation S Offering, as described below, at exercise prices ranging from $0.31 to $0.56 per share of Class A common stock for each Class I warrant exercised.

In December 1996, the Company received $185,000 in cash relating to an offering to qualified foreign investors under Regulation S of the Securities Act of 1933 with the issuance of 228,571 and 134,454 shares of Class A common stock in 1996 and 1997, respectively. Also, in 1997, $228,999 was received and 977,367 shares of Class A common stock were issued. In 1999, the remaining Class I warrants were extended to June 22, 2003, and were later extended again to June 22, 2005. All Class I warrants were either exercised or expired in June 2005.

The following table sets forth the exercises and expirations of Class I warrants and the proceeds received for those exercises:

	Class I Warrants Exercised	Range of Exercise Prices	Proceeds Received	Class I Warrants Expired
2005	21,142	$ 0.5613 to $0.9375	$ 16,596	42,997
2004	116,249	$ 0.31 to $1.125	79,469	
2002	95,107	$ 0.31 to $1.125	62,881	
2001	56,727	$ 0.31 to $1.125	34,548	
1999	29,367	$ 0.9375	27,532	42,866

Series X and Series Y Warrants Issued in Connection with Preferred Stock

In connection with the issuance of preferred stock in 1998, 2,416,665 Series X warrants and 1,021,269 Series Y warrants were issued. The warrants are exercisable at $1.20 and $2.50 per share, respectively. Each of the warrants has cashless exercise features that are based on various conversion amounts and terms. The expiration date of the warrants was extended from November 2005 to November 2007. In 2002, 1,000 Series X warrants were exercised at a price of $1.20 per share, resulting in proceeds of $1,200. In 2006, 333,333 Series X warrants were exercised at a price of $1.20, resulting in proceeds of $400,000. Also in 2006, 8,325 Series X warrants were exercised using the cashless exercise feature, resulting in an issuance of 5,418 shares of stock. In 2007, 352,425 Series X warrants were exercised using the cashless warrant exercise feature, resulting in an issuance of 5,209 shares of stock. The remaining 1,304,082 Series X and 867,500 Series Y warrants expired in November 2007.

Series X and Series Y Warrants to Placement Agent

The Series A preferred stock shares were placed through a placement agent. The placement agent and certain officers of the placement agent were given Series X warrants to purchase, in the aggregate, 278.33 shares of the Company s common stock for each $1,000 of purchase price (417,495 shares) and Series Y warrants to purchase, in the aggregate, 102.7 shares of the Company s common stock for each $1,000 of purchase price (154,050 shares). The Series X warrants were originally exercisable for a period of six years from the first anniversary of the date of issuance at a price per share equal to $1.20 and the Series Y warrants were originally exercisable for a period of five years from the second anniversary of the date of issuance at a price per share equal to $2.50. The exercise period for both the Series X and Series Y warrants was extended by two years. No placement agent was used for the Series B and C preferred stock. In 2005, 6,564 Series X warrants were exercised at $1.20, resulting in proceeds of $7,877. In 2006, 254,372 Series X warrants were exercised using the cashless exercise feature, resulting in an issuance of 139,999 shares of stock. In 2007, the final 156,564 Series X warrants were exercised using the cashless warrant exercise feature, resulting in an issuance of 2,314 shares of stock. The remaining 153,769 Series Y warrants expired in November 2007.

Bonus Warrants

In connection with the exercise of the Class B and C Warrants during 1998 and 1999, the Company granted a new warrant on a one-for-one basis for each Class B and C Warrant exercised. The Bonus warrants, 1,054,670 and 257,994 issued in 1998 and 1999, respectively, were originally to expire February 12, 2001, but were extended to June 22, 2003, and later extended to June 22, 2005. They were exercisable at a price of $3.00 per share of Class A common stock for each Bonus warrant exercised. All of the Bonus warrants expired unexercised in June 2005.

Consulting and Placement Warrants

In 1997 and 1998, the Company obtained bridge financing of $3.2 million. In connection with the financing, 6,314,926 Consulting warrants and 378,895 Placement warrants were issued at an exercise price of $0.375. The expiration dates for all warrants were extended by two years in 2002. Since the issuance of the warrants, all of the Consulting and Placement warrants were either exercised or expired, as shown in the table below.

	Exercised		Expired	
Year Exercised/Expired	Consulting Warrants	Placement Warrants	Consulting Warrants	Placement Warrants
2005	2,016,332		1,379,926	
2004	1,573,333			
2003		9,400		
2002	416,667	195,605		
Prior to 2002	928,668	173,890		
	4,935,000	378,895	1,379,926	

Extension Warrants

In connection with the extension of an October 30, 1997 bridge financing, 310,000 extension warrants were issued at an exercise price of $0.375 per share of Class A common stock for each warrant exercised. The stock warrants were originally to expire on November 5, 2003, but the expiration date was extended to November 5, 2005. All 310,000 warrants were exercised in November 2005 for proceeds of $116,250.

Series Z Placement Warrants

In 1998, the Company issued 300,000 Series Z Placement warrants in connection with the issuance of the Series C preferred stock. These warrants are exercisable at a price of $1.00 per share of Class A common stock for each warrant exercised, and were originally to expire on November 12, 2003, but the expiration date was extended to November 12, 2005. All 300,000 warrants were exercised in October 2005 for proceeds of $300,000.

Series W Warrants Issued in Connection with Preferred Stock

In connection with the issuance of Series D preferred stock in 2007, the Company issued 3,787,880 Series W warrants. These warrants are exercisable at $1.38 per share and will expire on October 29, 2012. Each of the warrants also has a cashless exercise feature.

At December 31, 2007, the Company had warrants outstanding as follows:

	Warrants Outstanding for Class A Common Stock	Weighted Average Exercise Price	Expiration Date	Warrants Exercised in 2007
Class H warrants		0.47	02/21/07	1,771,792
Series X warrants		1.20	11/10/07	352,425
Series Y warrants		2.50	11/10/07	
Series X warrants placement agent		1.20	11/10/07	156,564
Series Y warrants placement agent		2.50	11/10/07	
Series W warrants	3,787,880	1.38	10/29/12	
Totals	3,787,880	$ 1.38		2,280,781

Effective June 30, 2001, the Company adopted Financial Accounting Standards Board SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), with no effects on its financial statements except for warrants that are indexed to and potentially settled in the Company s common stock, which includes all of the Company s warrants. These warrants have been accounted for under the provisions of Emerging Issues Task Force abstract 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock* (EITF 00-19). The Company modified certain of its warrant related registration rights agreements as of June 30, 2001, so that

those warrants would be classified as equity rather than debt in its balance sheet under the provisions of EITF 00-19. As a result of these modifications, there was no impact on earnings.

In accounting for its derivative contracts at June 30, 2001, the Company recorded $8,419,345 in warrants outstanding in the equity section of its balance sheet and decreased its additional paid-in capital by the same amount, leaving its total stockholder s equity amount unaffected. The warrant valuation was determined as of June 30, 2001 using the Black-Scholes option-pricing model, with the following details and assumptions. The underlying stock price was $0.87. Exercise prices of the warrants ranged from $0.31 to $3.00. The volatility of the stock underlying the warrants ranged from 46.42% to 87.27%, and the risk-free rates of return ranged from 3.63% to 4.82%.

Note 7: Stock Option Plans

The Company s stock option plans (the 1997 Plan, 1994 Plan, Director Plan, Chairman Plan and the 1989 Plan, collectively the Plans) authorize the issuance of 7,600,000 shares of the Company s Class A common stock to its directors, employees and outside consultants. The option price of the stock options awarded must be at least equal to the market value of the Class A common stock on the date of grant. Stock options may not be granted to an individual to the extent that in any calendar year in which options first become exercisable, the shares subject to options first exercisable in such year have a fair market value on the date of grant in excess of $100,000. No option may be outstanding for more than ten years after its grant. The purpose of the Plans is to enable the Company to encourage key employees, directors and outside consultants to contribute to the success of the Company by granting such persons incentive stock options (ISOs) and/or non-incentive stock options (nonqualified stock options). The ISOs are available for employees only. In order to provide for disinterested administration of the Plans for purposes of Rule 16b-3 under the Securities Exchange Act of 1934, the Director Plan also provides that outside directors will automatically receive annual awards of nonqualified stock options; however, no more options will be issued from the Director Plan, as all options authorized for issuance under the Director Plan have been issued, and the Company has adopted a separate non-employee director equity incentive plan (see Note 8).

The Company s stockholders approved the Non-Employee Director Stock Option Plan (the Director Plan), in June 1994. The Director Plan provides for the issuance of options to purchase up to an aggregate of 500,000 shares of the Company s Class A common stock to eligible outside directors of the Company. Each eligible outside director was granted options to purchase 25,000 shares of common stock annually commencing in 1995 and each year thereafter through 2004. The plan expired in 2004, and options can no longer be issued under this plan.

In June 1994, stockholders of the Company approved the adoption of the Amended and Restated Stock Option Plan (the 1994 Plan), which superseded and replaced the Company s 1990 Stock Option Plan. The 1994 Plan provides for the granting of options to purchase up to 1,000,000 shares of the Company s Class A common stock by recipients of incentive stock options or nonqualified stock options as granted by the Company s Board of Directors. The 1994 Plan has expired, and no more stock options can be issued under that plan.

Also, in June 1994, stockholders of the Company approved the Chairman Stock Option Plan. This plan provided for a grant of options to purchase up to 500,000 shares of the Company s Class A common stock. Those options have all been issued.

In July 1997, stockholders of the Company approved the adoption of the Advanced Environmental Recycling Technologies, Inc. 1997 Securities Plan (the 1997 Plan). The 1997 Plan provides for certain awards to be given to senior and executive management of the Company to encourage and reward superior performance. The awards can be in the form of stock options, restricted stock, and other performance awards to be given. The aggregate number of shares which may be offered pursuant to incentive stock options under the 1997 Plan originally was not to exceed 3,000,000, but this amount was increased by approval of the stockholders to 5,000,000 in July 1999. The aggregate number of shares which may be offered for purchase pursuant to non-qualified stock options shall not exceed 500,000 shares. The stock options may not be granted with an exercise price less than the fair market value of a share on the date the option is granted,

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unless granted to a 10% shareholder, then the exercise price must be at least 110% of the fair market value per share on the date such option is granted. The Incentive Stock Options may not be exercised after ten years from the date the option is granted unless the option is given to a 10% shareholder, and then the expiration date is five years from the date the option is granted. The options must be exercised within three months after termination of employment.

A summary of the activity in the Company s stock option plans during the years ended December 31, 2007, 2006, and 2005, follows:

	2007		2006		2005	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	2,872,130	$ 1.09	3,688,130	$ 1.01	4,595,230	$ 1.06
Granted						
Exercised	(1,333,130)	0.49	(791,000)	0.60	(377,600)	0.49
Forfeited	(17,500)	1.06	(25,000)	2.00	(529,500)	1.79
Outstanding, end of year	1,521,500	$ 1.59	2,872,130	$ 1.09	3,688,130	$ 1.01
Exercisable, end of year	1,521,500	$ 1.59	2,872,130	$ 1.09	3,638,130	$ 1.01

The following table summarizes information about stock options outstanding under the Company s stock option plans as of December 31, 2007. All options were exercisable at December 31, 2007.

	Options Outstanding and Exercisable		
Range of Exercise Prices	Number at 12/31/07	Wtd. Avg. Remaining Contract Life	Wtd. Avg. Exercise Price
$0.86 $0.94	224,000	2.42 years	$ 0.89
$1.10 $1.75	790,000	3.55 years	1.24
$2.25 $2.75	507,500	3.26 years	2.45
	1,521,500	3.29 years	$ 1.59

The weighted-average fair value of options granted during 2004 was $0.93.

Note 8: Equity Incentive Plans

2005 Key Associate and Management Equity Incentive Plan

The purpose of the Associate Plan is to further the growth and development of the Company by providing, through ownership of stock of the Company, an incentive to officers and other key associates (each of whom are employees of the Company for tax purposes) who are in a position to contribute materially to the prosperity of the Company including, but not limited to, all salaried personnel of the Company, to increase such persons interests in the Company s welfare, to encourage them to continue their services to the Company, and to attract individuals of outstanding ability to enter the employment of the Company.

The Associate Plan is currently administered by the compensation committee (the Administrator) of the board of directors. The Administrator has the power and authority to select and grant to participants restricted stock awards pursuant to the terms of the Associate Plan. Any employee of the Company is eligible to receive an award under the 2005 Associate

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Plan. No director who is not also an employee will be eligible to receive an award under the Associate Plan.

The stock available for awards under the Associate Plan are shares of the Company s authorized but unissued, or reacquired, common stock. The aggregate number of shares which may be issued pursuant to awards granted under the Associate Plan may not exceed 1,500,000 shares of common stock. In the event that any outstanding award for any reason expires, is forfeited or is terminated, the shares of common stock allocable to the unvested portion of the award will again be available for awards under the Associate Plan as if no award had been granted with respect to such shares.

The terms and conditions of the restricted stock purchase agreements or award may change from time to time, and the terms and conditions of separate restricted stock purchase agreements need not be identical, but each restricted stock purchase agreement will include the substance of each of the following provisions:

(a) *Purchase Price.* The purchase price of restricted stock awards shall be determined by the Administrator, and may be stated as cash, property or prior services performed.

(b) *Consideration.* The consideration for common stock acquired pursuant to the restricted stock purchase agreement will be paid either: (i) in cash at the time of purchase; or (ii) in any other form of legal consideration that may be acceptable to the Administrator in its discretion including, without limitation, a recourse promissory note, property or a stock-for-stock exchange or prior services that the Administrator determines have a value at least equal to the fair market value of such common stock.

(c) *Vesting.* Shares of common stock acquired under the restricted stock purchase agreement or awards may, but need not, be subject to a restricted period that specifies a right of repurchase in favor of the Company in accordance with a vesting schedule to be determined by the Administrator, or forfeiture in the event the consideration was in the form of prior services. In general, it is anticipated that, except as the Administrator may otherwise determine in its discretion, awards will vest (and prior thereto shall be subject to such a restricted period) over a three-year period, with 20% of a particular award vesting on the first anniversary thereof, an additional 30% of such award (50% cumulatively) vesting on the second anniversary of the award, and the 50% balance of the award vesting on the third anniversary of the award.

In 2006, seventeen associates were granted a total of 225,000 shares of restricted stock pursuant to the Associate Plan. In 2005, one employee was granted 50,000 shares under the plan. The total dollar value of the 2006 and 2005 awards was $708,750 and $78,750, respectively, and was initially recorded as deferred equity compensation. The value of the awards is amortized over the vesting period of the awards and charged to compensation expense. There were no restricted stock grants to employees in 2007.

2005 Non-Employee Director Equity Incentive Plan

The purpose of the Director Plan is to further the growth and development of the Company by providing, through ownership of stock of the Company, an incentive to non-employee directors to encourage them to continue their director services to the Company, and to attract individuals of outstanding ability to accept director positions for the Company. The Director Plan will initially be administered by the compensation committee (the Administrator) of the board of directors, and thereafter by such committee as the board may from time to time designate (or by the board itself, if it shall so designate).

Each director of the Company who is not also an employee of the Company is eligible to receive, and will automatically receive, an annual award under the Director Plan. There were, as of December 31, 2005, nine non-employee directors who are eligible to participate in the Director Plan (including non-employee directors who are not independent directors). The stock available for awards under the Director Plan are shares of the Company s authorized but unissued, or reacquired, common stock. The aggregate number of shares which may be issued pursuant to awards granted under the Director Plan will not exceed 500,000 shares of common stock. In the event that any outstanding award under the Director Plan for any reason expires, is forfeited or is terminated, the shares of common stock allocable to the

unexercised portion of the award shall again be available for awards under the Director Plan as if no award had been granted with respect to such shares.

The major terms of the restricted stock awards are as follows:

(a) *Restricted Stock Awards.* Effective as of the third business day each year following the earlier of (i) the Company s announcement by press release or other widely disseminated means of its results of operations (including both definitive revenue, net income, and earnings per share data) for the preceding fiscal year of the Company, or (ii) the Company s filing with the Securities and Exchange Commission of its Annual Report on Form 10-K for the preceding fiscal year of the Company, each eligible director then serving shall be granted pursuant hereto, in consideration of his or her services as a director to that point and as an inducement to further services in such capacity, a restricted stock award equal to the number of shares of common stock determined by dividing thirty thousand dollars ($30,000) by the fair market value, which for such purposes shall be deemed to be the average closing sale price of the common stock over the 50-business day period immediately preceding the effective date of such awards, to vest (and prior thereto shall be subject to a restricted period as defined herein) over a three-year period, with 20% of a particular award vesting on the first anniversary thereof, an additional 30% of such award (50% cumulatively) vesting on the second anniversary of the award, and the 50% balance of the award vesting on the third anniversary of the award; provided, however, as an inducement for new directors to serve, in the event new non-employee directors are elected or added to the board after the date of the annual award in any fiscal year, such new directors will be entitled to an initial restricted stock award equal to a pro rated (by fiscal quarters) portion of the usual $30,000 annual award, such that the new director will be credited for such pro rating purposes with one fiscal quarter of service for every fiscal quarter of the Company, or any portion thereof, during which such person will serve as a director in such initial fiscal year of service, divided in such case by the average closing sale price of the common stock over the 50-business day period immediately preceding such new director s election or appointment to the board of directors. Such initial restricted stock awards to new directors shall vest over a three-year period in the same manner as other awards pursuant to the Director Plan.

(b) *Termination of Participant s Continuous Service.* In the event a participant s continuous service as a director terminates for any reason, the Company may exercise its right of repurchase or otherwise reacquire, or the participant shall forfeit unvested shares acquired in consideration of services performed or performable.

In 2007, 17,341 shares each were granted to nine directors, one of whom forfeited said grant upon his retirement from the board of directors in June 2007, and 14,516 shares were granted to one director for a total of 153,244 shares net of forfeits. In 2006, nine directors were each granted 15,000 shares of restricted stock pursuant to the Director Plan, for a total of 135,000 shares. In 2005, seven directors were each granted 20,848 shares pursuant to the Director Plan, and two directors were each granted 11,278 shares for a total of 168,492 shares. The total dollar value of the 2007, 2006, and 2005 awards were $262,500, $270,000, and $240,000, respectively, and were initially recorded as deferred equity compensation. The value of the awards is amortized over the vesting period of the awards and charged to director compensation expense.

Note 9: Leases

In July 2006, AERT entered into a lease contract whereby it has agreed to lease up to $3 million of equipment for seven years. Lease payments will begin in the second quarter of 2008. Until that time, the Company made interim interest payments on the amount of equipment subject to the lease that had been purchased by the leasing company, which totaled approximately $2.8 million at December 31, 2007.

At December 31, 2007, the Company was obligated under various operating leases covering certain buildings and equipment. Rent expense under operating leases for the years ended December 31, 2007, 2006 and 2005 was $4,306,006, $3,688,178, and $3,381,404, respectively. These amounts for rent expense are considerably higher than the future minimum lease payments each year shown in the table below due to many of our operating equipment leases having a duration of less than one year.

During 2007, the Company also leased certain ERP software, computer equipment, and production equipment under four individual, non-cancelable capital leases. One of the production equipment leases expired in 2007. The remaining leases have various terms but all include a bargain purchase option upon expiration, with the production equipment lease expiring first, in 2008, the computer equipment lease in 2010, and finally the software lease in 2012.

Lease payments for capital lease obligations in 2007 totaled approximately $133,000, with the software and computer leases not beginning until December.

Future minimum lease payments required under operating and capital leases as of December 31, 2007, are as follows:

Year	Capital Leases	Operating Leases
2008	$ 285,610	$ 2,873,535
2009	261,330	2,366,448
2010	256,161	2,011,795
2011	199,303	1,926,455
2012	182,695	1,396,834
Thereafter		1,762,189
Total minimum payments required	1,185,099	$ 12,337,255
Less amount representing interest	163,954	
Present value of future minimum lease payments	1,021,145	
Less current obligations under capital leases	224,840	
Long-term obligations under capital leases	$ 796,305	

Note 10: Income Taxes

The Company records income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. Under this method, deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The Company s income tax provision (benefit) consisted of the following:

	Year Ended December 31,		
	2007	2006	2005
Current:			
Federal	$	$ 14,639	$ 80,000
State	$		105,200
	$	14,639	185,200
Deferred:			
Federal	$ (2,824,724)	(645,696)	(4,823,917)
State	$ (569,761)	(204,880)	189,035
	(3,394,485)	(850,576)	(4,634,882)
Net income tax benefit	(3,394,485)	$ (835,937)	$ (4,449,682)

The income tax benefits for 2007, 2006, and 2005 differ from the amounts computed by applying the US federal statutory rate of 34% to income taxes as a result of the following:

2007		2006		2005	
Amount	Percent	Amount	Percent	Amount	Percent

Income tax at the U.S. federal statutory rate	$ (4,389,959)	(34.0)	$ 329,319	34.0	$ 1,138,321	34.0
Net operating loss carryforwards			(25,664)	(2.6)	(1,024,489)	(30.6)
State income taxes	(570,834)	(4.4)		0.0	105,200	3.1
Dividends on preferred stock	423,672	3.3		0.0	276,000	8.2
Change in valuation allowance	1,486,354	11.5		0.0	(4,634,882)	(138.4)
Update estimate for prior year deferred taxes	)	0.0	(796,907)	(82.3)		0.0
Stock option exercises	(251,184)	(1.9)	(349,561)	(36.1)		0.0
Other	(92,534)	(0.7)	6,876	0.7	(309,832)	(9.3)
	$ (3,394,485)	(26.3)	$ (835,937)	(86.3)	$ (4,449,682)	(133.0)

The tax effects of significant temporary differences representing deferred tax assets and liabilities were as follows:

	2007		2006		2005	
	Current	Long-Term	Current	Long-Term	Current	Long-Term
Deferred tax assets-						
Net operating loss carryforwards	$ 146,702	$ 11,476,946	$ 1,394,000	$ 6,068,918	$ 2,036,962	$ 5,193,366
Alternative minimum tax credit carryforward		75,838		70,308		64,000
Allowance for sales returns	455,700		147,408			
Accrued expenses	12,434	239,201	22,145	239,933		
Deferred compensation	150,553					
Charitable contribution	47,966					
Inventory overhead capitalization	107,299					
Valuation allowance	(570,809)	(915,545)				
Total deferred tax assets	349,845	10,876,440	1,563,553	6,379,159	2,036,962	5,257,366
Deferred tax liability-						
Depreciation		2,025,028		2,085,247		2,659,446
Prepaid expenses	349,845		400,536			
Total deferred tax liabilities	349,845	2,025,028	400,536	2,085,247		2,659,446
Net deferred tax	$	$ 8,851,412	$ 1,163,017	$ 4,293,912	$ 2,036,962	$ 2,597,920

As of December 31, 2007, the Company had net operating loss carryforwards of approximately $32.6 million for federal income tax purposes, which are available to reduce future taxable income and will expire in 2008 through 2027. The Company evaluated the need for a valuation allowance as of December 31, 2007 and 2006, and 2005, and in 2006 and 2005 determined it was more likely than not that it would generate enough taxable income to fully utilize the net operating loss carryforwards prior to their expiration. In eliminating the valuation allowance in 2005, the Company recorded a deferred tax asset of $7.3 million for its net operating loss carryforwards, reduced by a deferred tax liability of approximately $2.7 million for the difference between its net property, plant and equipment for income tax purposes and financial reporting purposes. The current portion of the net operating loss carryforward in 2006 and 2005 represents the portion that we expected to utilize in the subsequent year. The net impact of eliminating the valuation allowance is reflected as an income tax benefit on the statement of operations for the year ended December 31, 2005.

The Company determined that it is more likely than not that it will not generate enough taxable income to fully utilize its net operating loss carryforwards expiring in 2008 and 2009, and, as a result, recorded a valuation allowance of $1,486,354 as of December 31, 2007 to reduce its deferred tax asset to the amount that is more likely than not to be realized. The Company determined that it is more likely than not that it will fully utilize the net operating loss

carryforwards that expire subsequent to 2009. In evaluating the need for and amount of a valuation allowance, the Company considered the following criteria to have the most significant impact on its determination:

Future reversals of existing taxable temporary differences

Recent historical utilization of net operating loss carryforwards

The timing and extent of expected net margin increase from recently implemented and planned changes to operations and projected sales growth

Note 11: Extraordinary Item

On March 28, 2003, the Company had an accidental fire at its Junction, Texas plant, which damaged or destroyed much of its equipment. The Company received $700,000 in a settlement from one of its insurance companies related to this fire in August 2007 (see Note 12: Commitments and Contingencies).

Note 12: Commitments and Contingencies

Legal Proceedings

Lloyd s of London

On July 31, 2007, the Company and certain underwriters at Lloyd s, London agreed to the terms of a settlement resolving litigation that arose in early 2005 concerning losses related to a fire in 2003. Under the settlement, Lloyd s, London paid the Company $700,000 in August 2007, and the parties provided mutual releases to one another.

Advanced Control Solutions

On February 7, 2008, the Arkansas Supreme Court rejected our appeal in the Advanced Control Solutions (ACS) case, and affirmed the judgment of the circuit court, where a jury in March 2006 found us liable for interfering with a non-compete agreement, causing ACS to lose future business opportunities and for missing equipment. The Arkansas Supreme Court also denied ACS s appeal of the $45,562 plus attorney s fees awarded to us in March 2006 on our counterclaim against ACS for breach of contract. We do not intend to appeal the case further.

Our liability for the original judgment in the amount of $655,769 was recorded in 2005. The judgment will be paid from funds we set aside in a restricted certificate of deposit in 2006.

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.

Construction Agreement

The Company has entered into an agreement with a construction contractor to construct part of its Watts plastic recycling plant. The contractor will manage the grading, drainage, on-site road construction, and building pad construction, and will have an opportunity to propose designs for buildings and certain infrastructure needed to support operations on the site. The agreement does not contain a minimum purchase amount for the work to be performed by the contractor.

Marketing Agreement

The Company has entered into an exclusive sales and marketing agreement in the amount of $2 million with Nicholson-Kovac, an integrated marketing communications agency, to support its MoistureShield decking products. The agreement includes a national trade and consumer media schedule, national advertising, revamped website, online lead generation tool for builders, national public relations campaign and market research. At December 31, 2007, approximately $1.8 million was remaining under this commitment.

Note 13: 401(k) Plan

The Company sponsors the A.E.R.T. 401(k) Plan (the Plan) for the benefit of all eligible employees. The Plan qualifies under Section 401(k) of the Internal Revenue Code thereby allowing eligible employees to make tax-deferred contributions to the Plan. The Plan provides that the Company may elect to make employer-matching contributions equal to a percentage of each participant s voluntary contribution. The Company may also elect to make a profit sharing contribution to the Plan. The Company has never made any matching or profit sharing contributions to the Plan.

INDEX TO EXHIBITS

Exhibit No.	Description of Exhibit
3.1	Certificate of Incorporation, including Certificate of Amendment filed on June 12, 1989 (a), and Certificate of Amendment filed on August 22, 1989 (b), and Certificate of Amendment filed on December 29, 1999
3.2	Certificate of Designation of Class B common stock. (a)
3.3	Bylaws of Registrant. (a)
3.4	Form of Class A common stock Certificate. (c)
3.5	Certificate of Designation of Series D Preferred Stock filed October 29, 2007 (i)
4.2.1	Form of Class B common stock Certificate. (a)
10.1	Form of Right of Refusal Agreement among Class B common stockholders. (a)
10.2	Amended and Restated Stock Option Plan. (d)

Exhibit No.	Description of Exhibit
10.3	Non-Employee Director Stock Option Plan. (d)
10.4	Chairman Stock Option Plan. (d)
10.5	2005 Key Associate and Management Equity Incentive Plan (l)
10.6	2005 Non-Employee Director Equity Incentive Plan (l)
10.7	Indenture of Trust between City of Springdale and Regions Bank, Trustee, as of October 1, 2003. (n)
10.8	Mortgage and Loan Agreement between City of Springdale and Company, as of October 1, 2003.(n)
10.9	Assignment of Mortgage and Loan Agreement between City of Springdale and Regions Bank. (n)
10.10	Note Purchase Agreement between Company and Allstate Insurance Company dated October 9, 2003. (n)
10.11	Promissory Note made by Company dated October 9, 2003. (n)
10.12	Wood-Plastic Composite Decking Agreement between AERT and Weyerhaeuser Company, et al. effective October 12, 2004.* (Redacted in accordance with confidential treatment request, as filed October 15, 2005) (q)
10.13	Loan Agreement. (r)
10.14	Promissory Note. (r)
10.15	Loan Agreement. (s)
10.16	Promissory Note. (s)
10.17	Series D Convertible Preferred Stock Purchase Agreement dated October 29, 2007 (i)
10.17	Form of Warrants to Purchase Common Stock issued October 29, 2007 (i)
10.17	Registration Rights Agreement (i)
10.18	Loan Agreement dated December 19, 2007 related to Series 2007 8% Bonds. (j)
10.18	Indenture of Trust dated December 19, 2007 related to Series 2007 8% bonds. (j)
10.19	Indenture of Trust between City of Springdale, Arkansas, and Bank of Oklahoma, N.A., Trustee, relating to the issuance of $10,610,000 City of Springdale, Arkansas Industrial Development Refunding Revenue Bonds (Advanced Environmental Recycling Technologies, Inc. Project) Series 2008; dated as of February 1, 2008. (k)
10.19	Loan Agreement between City of Springdale, Arkansas, and Advanced Environmental Recycling Technologies, Inc., related to $10,610,000 City of Springdale, Arkansas Industrial Development Refunding Revenue Bonds (Advanced Environmental Recycling Technologies, Inc. Project) Series 2008; dated as of February 1, 2008. (k)
23.1	Consent of Independent Registered Public Accounting Firm. ***
31.1	Certification per Sarbanes-Oxley Act of 2002 (Section 302) by the Company s chairman, chief executive officer and president.***
31.2	Certification per Sarbanes-Oxley Act of 2002 (Section 302) by the Company s chief financial officer.***
32.1	Certification per Sarbanes-Oxley Act of 2002 (Section 906) by the Company s chairman, chief executive officer and president.***
32.2	Certification per Sarbanes-Oxley Act of 2002 (Section 906) by the Company s chief financial officer.***

* Confidential treatment was granted by the Securities and Exchange Commission for certain portions of this

agreement. The confidential portions were filed separately with the Commission.

The Registrant has no exhibits corresponding to Exhibits 1, 2, 5, 6, 7, 8, 9, 11, through 23, or 26 through 29.

*** Filed herewith.

(a) Contained in Exhibits to Registration Statement on Form S-1, No. 33-29595, filed June 28, 1989.

(b) Contained in Exhibits to Amendment No. 1 to Registration Statement on Form S-1, No. 33-29595, filed August

24, 1989.

(c) Contained in Exhibits to Amendment No. 2 to Registration Statement on Form S-1, No. 33-29595, filed November 8, 1989.

(d) Filed with Form 10-K for December 31, 1994.

(e) Filed with Form 10-Q for September 30, 2003.

(f) Filed with Form 10-Q/A for September 30, 2004.

(g) Filed with Form 10-Q for September 30, 2005.

(h) Filed with Form 10-Q for September 30, 2006.

(i) Contained in exhibits to Form 8-K filed November 1, 2007.

(j) Contained in exhibits to Form 8-K filed December 21,

2007.

(k) Contained in exhibits to Form 8-K filed February 29, 2008.

(l) Contained in exhibits to DEFR14A filed July 11, 2005.