

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC  
Form 10-K  
March 06, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2013

Or

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  
(State of Incorporation)

71-0675758  
(I.R.S. Employer  
Identification No.)

914 N Jefferson Street  
Springdale, Arkansas  
(Address of principal executive offices)

72764  
(Zip Code)

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

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

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

Class A common stock, \$.01 par value  
(Title of Class)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (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.

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  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(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). Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing stock price of such common equity as of the last business day of the registrant's most recently completed second fiscal quarter was \$13,490,594 (for the purposes hereof, directors, executive officers and 10% or greater shareholders have been deemed affiliates).

Number of shares of common stock outstanding at February 27, 2014: Class A — 88,165,632; Class B — 1,465,530

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of our Definitive Proxy Statement for our 2014 annual meeting scheduled to be held on June 19, 2014, and expected to be filed within 120 days of our fiscal year end, are incorporated by reference into Part III.

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## PART I

### Item 1. Business.

#### Summary

Advanced Environmental Recycling Technologies, Inc. (AERT or the Company), founded in 1988, develops and commercializes technologies to recycle waste polyethylene plastics and develops, manufactures, and markets value-added, green building compounds. Our primary products are 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. Our products are made primarily from approximately equal amounts of recycled polyethylene plastic, which has been cleaned, processed, and reformulated and waste wood fiber, which has been cleaned, sized and reprocessed utilizing our patented and proprietary technologies. Our products have been extensively tested, and are sold by leading national companies such as the BlueLinx Corporation (BlueLinx), Lowe's Companies, Inc. (Lowe's) and Therma-Tru Corporation. Our products are primarily used in renovation and remodeling by consumers, homebuilders, and contractors as an exterior environmentally responsible ("Green") building alternative for decking, railing, and trim products.

The Company currently manufactures all of its composite products at extrusion facilities in Springdale, Arkansas. The Company operates a plastic recycling, blending and storage facility in Lowell, Arkansas, where it also leases warehouses and land for inventory storage. The Company operates a plastic recycling, cleaning, and reformulation facility at Watts, Oklahoma. The Company also leases a warehouse in Westville, Oklahoma for inventory storage.

#### Products

Building on our base process and materials, we manufacture the following product lines:

- Commercial and residential decking planks and accessories such as balusters and handrails under the MoistureShield® and ChoiceDek® brands,
- Exterior door components,
- Exterior housing trim (MoistureShield®), and
- Green recycled plastic resin compounds.

The wood fiber content of our products gives them many properties similar to all-wood products, but we believe that the plastic content renders our products superior to both all-wood or all-plastic alternatives because:

- Unlike wood, our products do not require preservatives or treatment with toxic chemicals or annual sealing or staining.
- Our products are less subject to thermal contraction or expansion and have greater dimensional stability than competing all-plastic products.
- Our products are engineered for superior moisture-resistance and will not decompose like wood.
- Our products are designed and extruded through dies to a desired shape in accordance with customer specifications, which helps the customer to minimize waste.

- Our products are less subject to rotting, cracking, warping, splintering, insect infestation, and water absorption than conventional wood materials.
- Our products are aesthetically enhanced to provide a wood-like or grained surface appearance.
- Our products are combined with coloring agents and/or other additives to provide various colors and aesthetics.

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- Since 2006, our product has contained a mildew-cide to inhibit the growth of mold.
- Our latest generation of products offers colors to more closely resemble the natural look of wood.

Based upon our extensive product testing and successful extended field history, we offer a 25-year limited replacement warranty on our ChoiceDek® Foundations™ and a limited lifetime replacement warranty on our MoistureShield® products against rot and fungal decay, and termite and insect damage.

#### Marketing and Sales

**General Market Strategy.** 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 annual maintenance in the form of staining or 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 and door and other OEM components; that represent the most attractive market opportunities at this time. Within our chosen markets, we are constantly working to develop and improve strong customer relationships.

**Sales and Customer Service.** We provide sales support and customer service through our own marketing department, contract marketing through outside commissioned representatives, through BlueLinx, 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 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 distributors, as well as BlueLinx and Lowe's. Information and customer service are provided through the websites [www.choicedek.com](http://www.choicedek.com) and [www.moistureshield.com](http://www.moistureshield.com), and through a national toll-free customer assistance telephone number: 1-800-951-5117.

**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. Reductions in such activity have 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 ongoing pursuit to satisfy our customers and to keep up with changing trends in the marketplace, we continuously work to develop new products and improve existing products. 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. The aesthetics of our products, which are overwhelmingly composed of recycled materials, have improved with technology advances. The startup of our next-generation Watts, Oklahoma recycling facility allows us to expand into additional customer-driven opportunities.

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

#### 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. Our Watts, Oklahoma facility,

which is designed to recover, utilize, and convert lower grades of waste plastics into usable feed stocks, is an example of our efforts to continually improve our recycling technology. By utilizing technology, we are upgrading the quality and aesthetics of our products made primarily from recycled raw materials to levels comparable to virgin resin based products.

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## Green Building Products

We have been recycling plastic and manufacturing green building products since our inception in 1988, and we intend to continue building our brands and differentiating AERT as a green building products company. Listed below are the major categories of products we manufacture and markets we supply.

**ChoiceDek® Decking.** We currently sell our ChoiceDek® branded decking products in the home improvement warehouse (HIW) market through BlueLinx to Lowe's. We derived a majority of our revenue (64%) from BlueLinx (our distributor for ChoiceDek® products) in 2013. This market segment primarily focuses on the do-it-yourself (DIY) market in which homeowners buy, build, and install their own decks. The ChoiceDek® brand is sold exclusively to Lowe's. ChoiceDek® is promoted through in-store displays and an ongoing print and marketing campaign targeting the residential decking market. We maintain a nationwide sales and customer service group. Lowe's also conducts national print and television ads for the products it carries. ChoiceDek® introduced its new line, ChoiceDek® Foundations™ in 2012. This newly engineered product provides better fade performance than our previous product and features a smaller profile, making it more lightweight and easier to handle.

**MoistureShield® Decking.** Our MoistureShield® brand line of decking products 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. One international distributor accounted for 10% of our sales in 2013. Most of our MoistureShield® 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. The MoistureShield® decking line allows us to diversify our customer base.

**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 these products, 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. We are unable to predict the future size of the markets for MoistureShield® industrial products; however, we believe that the national door and window and commercial and residential trim markets are large and will allow us to diversify our customer base over time as we add production capacity and focus on additional opportunities.

**Exterior Trim and Fascia Products.** We have marketed an exterior trim and fascia system under the trade name MoistureShield® Trim. Several national homebuilders have been specifying and using the product. We believe this product line has significant growth potential as a green alternative to plastic (i.e., PVC) and wood trims to be distributed and sold in conjunction with our MoistureShield® distributors.

## Competition

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 characteristics, which make them a better value for the consumer; however, they are more expensive initially than traditional wood products. Additionally, manufacturers of some competing products have long-established ties to the building and construction industry and have well-accepted products. Some 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. 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. 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 not only on durability, but also the ability of the customer to order a product that is custom manufactured to its specifications.

## Intellectual Property and Proprietary Technology

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 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. Our patents expire between 2015 and 2028.

Our patents cover plastic recycling processes, methods, and apparatus or specially designed equipment as well as the composite product that we manufacture. The composite product patent was issued in 1998 and expires in 2015. This patent covers the unique properties, formulation and processing parameters of our encapsulated wood/polyethylene plastic composite building material. We have also received patents with regard to our mixed recycled plastic resin identification and reformulation technologies.

We have updated and continue to refine our recycling processes, procedures, and technologies, and included these in later issued patents or pending patent applications. We have taken additional measures to protect our intellectual property and trade secrets by restricting access to our facilities and maintaining a policy of nondisclosure, which includes requiring confidentiality and nondisclosure agreements among our associates.

## Raw Materials

**Wood Fiber.** The wood fiber we use is primarily waste byproduct generated by hardwood furniture, cabinet, and flooring manufacturers. However, we see competition for scrap wood fiber for use as a fuel to replace other fuels for both residential and industrial applications.

**Recycled Plastics.** We use primarily post-consumer waste polyethylene. The largest portion of the plastic materials we use is mixed with paper and other non-plastic materials, which lessens its value to other plastic recyclers. By principally sourcing these contaminated waste plastics prior to processing; we produce a usable but lower-cost feedstock for our composite extrusion lines. We believe our investments in recycling technology and infrastructure will create a significant raw material cost advantage compared to several of our virgin resin-based competitors while offering a more competitive green building product.

**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 more contaminated polyethylene limits the number of competitors. Nonetheless, we expect to continue to encounter new entrants into the plastics reclamation business. We increased our capacity for processing waste plastic in recent years, which reduced our dependence on outside suppliers and gave us more control over our costs.

## Industry Standards

Building codes exist to provide for safe and effective structures and consistency of structures and construction practices. Our decking and railing products comply with the International Building Code and the International Residential Code as well as the 1997 Uniform Building Code™ (UBC) and the BOCA® National Building Code/1999 (BNBC). The International Code Council – Evaluation Service (ICC-ES) publishes evaluation reports for building products. These reports tell the consumer, commercial or residential, that the products listed in the report comply with code when they are used in the prescribed application and installed according to the manufacturer's installation instructions. In 2009, we converted from the legacy evaluation report, NER-596, to ESR-2388 from ICC-ES. In Canada, compliance of our products to code is documented in evaluation report CCMC 13191-R from the Canadian Construction Materials Center. We utilize an independent third-party to ensure continuing compliance of our products

to code.

The Company has also received from ICC-ES a Verification of Attributes Report (VAR-1015) that verifies the content of recycled materials in our decking, railing and OEM products.

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## Employees

Due to the seasonality of our business and timing of orders received from our largest customer, the number of permanent employees is adjusted throughout the course of the year. At December 31, 2013 we had 415 compared to 371 employees at December 31, 2012.

## Available Information

We post on our website ([www.aert.com](http://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 pursuant to Section 13(a) of the Securities Exchange Act as soon as reasonably practicable after we electronically file such material with the SEC.

## Item 2. Properties.

We currently manufacture all of our composite products at extrusion facilities in Springdale, Arkansas where we also lease our corporate office space.

We operate a facility in Lowell, Arkansas that is used for plastic recycling, blending, and storage. Additionally, we lease warehouses and land in Lowell for inventory storage.

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 was being leased from Razorback Farms. Lease payments commenced on January 1, 2009, and were equal to \$0.0075 per one pound of recycled resin produced from the production facility, with a minimum rent of \$1,000 per month. The throughput or production rent was due quarterly and was capped throughout the term of the lease not to exceed \$450,000 per year.

In March 2013, the Company purchased the 60 acres in Adair County from Razorback Watts. As a result of this transaction, no rent expense was recognized in 2013 for this property.

The Company also leases a warehouse in Westville, Oklahoma for inventory storage.

## Item 3. Legal Proceedings.

See Note 12: Commitments and Contingencies

## Item 4. Mine Safety Disclosure.

Not applicable.

## PART II

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

The Company's common stock is currently listed with the OTC Bulletin Board and trades under the symbol of AERT. As of December 31, 2013, there were approximately 1,403 holders of record of our Class A common stock and 5 holders of record of our Class B common stock. The closing price of our common stock was \$0.11 on December 31, 2013. We have not previously paid cash dividends on our common stock and there are currently restrictions under various debt obligations and our Series E 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 of our Class A common stock for the years ended December 31, 2012 and 2013.

## Sales Price Range of Class A Common Stock

	High	Low
Fiscal 2012		
First Quarter	0.09	0.07
Second Quarter	0.10	0.06
Third Quarter	0.15	0.05
Fourth Quarter	0.12	0.08
Fiscal 2013		
First Quarter	0.24	0.09
Second Quarter	0.22	0.18
Third Quarter	0.19	0.12
Fourth Quarter	0.15	0.10

No repurchases of common stock took place during 2012 or 2013.

## Equity Compensation Plan Information

The following table provides information as of December 31, 2013, regarding shares outstanding and available for issuance under the Company's equity compensation plans. No awards were made in 2013 pursuant to the Company's 2012 Stock Incentive Plan, which was approved by security holders at the Company's annual shareholders' meeting on June 27, 2012.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column of this table)
2012 Equity compensation plans approved by security holders	-	N/A	40,000,000
Equity compensation plans not approved by security holders	-	N/A	-
	-		40,000,000

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

## 2013 Summary

Results of Operations  
Two Year Comparison (in thousands)

	2013	2012	Change	%
Net sales	\$68,779	\$74,611	(7.8	%)
Cost of goods sold	56,976	61,328	(7.1	%)
% of net sales	82.8	82.2	%	%
Gross margin	11,803	13,283	(11.1	%)
% of net sales	17.2	17.8	%	(3.6 %)
Gain from asset disposition	9	38	(76.3	%)
Selling and administrative costs	11,535	11,070	4.2	%
% of net sales	16.8	14.8	%	%
Operating income	277	2,251	(87.7	%)
% of net sales	0.4	3.0	%	%
<b>Other Income:</b>				
Income from insurance proceeds	2,500	-	*	
Other income	162	52	*	
<b>Other expenses:</b>				
Other expense	(82 )	-	*	
Net interest expense	(2,920 )	(2,972 )	(1.7	%)
Loss before dividends	(63 )	(669 )	(90.6	%)
% of net sales	(0.1 %)	(0.9 %)		
Dividends on preferred stock	(1,401 )	(1,320 )	6.1	%
Net loss applicable to common stock	\$(1,464 )	\$(1,989 )	(26.4	%)
% of net sales	(2.1 %)	(2.7 %)		

\* Not meaningful as a percentage change

## Sales

Net sales for the year ended December 31, 2013 were down 7.8% from the year ended December 31, 2012 largely due to lost production as a result of a fire on July 17, 2013 at the extrusion facility in Springdale. The first line at the extrusion plant re-commenced operations on August 16, 2013. The remaining four lines were brought back into operation between August 17 and August 23, 2013. Final adjustments and repairs to the extrusion line are still in progress.

MoistureShield® and export sales increased in the fourth quarter of 2012 due to significant shipments under the Winter Buy program. As a result, MoistureShield® and export sales were 19.3% lower in 2013 than in 2012.

## Cost of Goods Sold and Gross Margin

Cost of goods sold decreased 7.1% for the year ended December 31, 2013 compared to 2012. As a percentage of sales, 2013 cost of goods sold was 0.6 percentage points higher than 2012 reflecting increased manufacturing overhead, in

addition to direct labor costs incurred due to the retention of our skilled labor force during the time of lost production. In the third quarter of 2012, a portion of the net settlement recovery from Ross Systems, Inc. was offset against manufacturing costs previously incurred.

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### Selling and Administrative Costs

Selling and administrative costs were up 4.2% in 2013 compared to 2012. In 2012, a portion of the net settlement recovery from Ross Systems, Inc. was offset against administrative costs previously incurred. Selling and administrative costs also increased due to the hiring of additional employees, additional research and development costs, and the amortization of bank fees.

As a percentage of sales, selling and administrative costs were up 1.9% from 2012. The primary components of selling and administrative costs are compensation and benefits, advertising and promotion, travel, professional fees, and commissions.

### Asset Impairment, Disposition and Other Expenses

On July 17, 2013, the Company experienced a fire at its Springdale North extrusion facility and a silo fire on July 25, 2013, at its Lowell facility. These facilities were closed temporarily while the Company, local, state, and federal officials investigated and repairs were made. The Lowell plant re-commenced operations on July 30, while the first line at the extrusion plant re-commenced production on August 16. The remaining four extrusion lines were brought back into operation between August 17 and August 23, 2013. Final adjustments and repairs to the extrusion lines are still in progress.

Estimated costs for personal and real estate damage at the Springdale facility are between \$0.5 million and \$1.0 million. The Company feels it has adequate insurance to cover any and all repairs needed as a result of the fire.

Damage sustained at the Lowell facility was predominately one silo, its contents, and related infrastructure. Damage is estimated at \$0.5 million.

### Other Income and Expense

The Company included the \$2.5 million insurance advance received in partial settlement of the Springdale fire in October 2013, as other income on the Statement of Operations. AERT has not yet filed a claim for the damage to property sustained in the Springdale fire. AERT submitted a preliminary claim for business interruption. The Company expects to file a claim for the business interruption portion in the first quarter of 2014. A claim for the real and personal property will be filed later in 2014. Although our insurance underwriters have yet to finalize their determination as to the nature of the loss, because a claim was not filed for property damage as of December 31, 2013, the Company determined that the full amount of the proceeds received in October 2013 related to business interruption. It is our belief that the majority of the settlement will be as a result of business interruption.

### Net Income (Loss)

AERT generated operating income of \$0.3 million for 2013. After consideration of the insurance advance as a result of the fire, and the deduction for interest and dividends, the Company had a net loss of \$1.4 million, an improvement of \$0.5 million in net income over 2012.

### Liquidity and Capital Resources

Liquidity refers to the liquid financial assets available to fund our business operations and pay for near-term obligations as well as unused borrowing capacity under our revolving credit facility. Our cash requirements have historically been satisfied through a combination of cash flows from operations and debt financings.

The Company continues to improve on liquidity by increasing plant efficiencies, decreasing our overhead costs, negotiating longer payment terms with vendors, and increasing profitability within our product sector.

## Cash Flows

### Cash Flows from Operations

Cash provided by operations for 2013 was \$2.3 million, an increase of \$0.7 million over 2012. A comparison between the years ending December 31, 2012 and December 2013 shows a change in current assets and current liabilities of \$1.7 million. This change is primarily due to:

- lower sales offset by lower cost of goods sold,
- an increase in inventories in 2013 due to increased production in anticipation of 2014 sales,
- and unusual items, including the Ross Systems, Inc. settlement, class action settlement payments, and business interruption insurance recovery.

The changes in our revenue and cost of raw materials significantly impact the Company's liquidity. We are in the remodeling industry that has been depressed as a result of the reduction in home prices in recent years. Our business is dependent upon the economy and we cannot accurately predict cyclical economic changes or the impact on consumer buying.

The Company has significant customer concentration, with one customer representing more than 64% of our revenue. A loss of this customer, or a major reduction in their business, could cause a significant reduction in our liquidity. We are currently working to expand our distribution network, which will reduce this customer's concentration.

### Cash Flows from Investing Activities

Cash used in investing activities in 2013 increased slightly from 2012, by \$0.3 million. Cash used was primarily due to additional capital expenditures at our Springdale, Arkansas plants to install a new co-extrusion line that the Company anticipates will be in operation during the first quarter of 2014.

### Cash Flows from Financing Activities

Cash provided by financing activities was \$0.9 million in 2013 compared to \$0.8 million in 2012. Cash provided by financing activities was primarily due to increased borrowing on the AloStar line of credit. In 2012, the Company entered into an agreement with AloStar Bank for a new Term Loan and a line of credit. The Term loan from AloStar was used to pay down the outstanding loans with Liberty Bank.

## Working Capital

At December 31, 2013, the Company had working capital of \$2.6 million compared to working capital of \$0.2 million at December 31, 2012. The increase in working capital for 2013 was primarily due to the business interruption insurance recovery that was credited to other income.

## Property, Plant and Equipment

The changes in our property, plant, and equipment for 2013 are due primarily to fixed asset additions to our Springdale, Arkansas extrusion facilities.

## Arkansas Loan Program

On March 30, 2010, the Company entered into a grant agreement with the City of Springdale and the Arkansas Economic Development Commission (AEDC) in the amount of \$170,000. Part of the grant funds were used to pay for

a new packaging line in the Springdale North plant. On June 4, 2010, the Company accepted an offer of additional grant funding in the amount of \$150,000 that became a part of the initial grant provided by AEDC, bringing the total amount of that grant to \$320,000. In 2011, \$70,000 of the grant fund was used to purchase a hammermill for the Springdale South location. The remainder of the grant funding was used when we removed and relocated equipment from AERT's plant at Junction, Texas to the Springdale South Plant. In 2012, the Company fulfilled its obligations to the City of Springdale and the AEDC with regards to this program.

## Debt

In addition to the H.I.G. transaction on March 18, 2011, as discussed in Note 5, and the obligations pledged to AloStar Bank of Commerce (AloStar) on November 15, 2012, also discussed in Note 5, the Company continues to explore financing options, including various financial assistance programs sponsored by state and federal governments.

## Line of Credit

The balance on our line of credit with AloStar was \$5.1 million at December 31, 2013. The amount available for draw down at December 31, 2013 was \$1.7 million.

## Oklahoma Energy Program Loan

On July 14, 2010, the Company entered into a loan agreement with the Oklahoma Department of Commerce (ODOC) whereby ODOC agreed to a 15-year, \$3.0 million loan to AERT at a fixed interest rate of 3.0%. The loan was made pursuant to the American Recovery and Reinvestment Act State Energy Program for the State of Oklahoma award number 14215 SSEP09, and funded the second phase of AERT's recycling facility in Watts, Oklahoma. The balance on the loan at December 31, 2013 was \$2.7 million.

## Debt Covenants

Our debt covenants per the Company's agreements with AloStar Bank of Commerce and H.I.G. are as follows:

	Year ended December 31, 2013		Compliance
	Actual	Required	
<b>AloStar Bank of Commerce Debt Covenants</b>			
Capital Expenditures	\$3.4	<\$4.5 million	Yes
Fixed Charge Coverage Ratio	1.86	> 1.10:1.00	Yes
Adjusted Consolidated EBITDA / Consolidated Fixed Charges			
Adjusted EBITDA	\$8.3 million	= >\$5.5 million	Yes
<b>H.I.G. Debt Covenants</b>			
Capital Expenditures	\$3.4	< \$2.5 million	No, Waived
Leverage Ratio	5.0	<= 3.1:1.00	No, Waived
Consolidated Indebtedness / Consolidated EBITDA			
Fixed Charge Coverage Ratio	2.0	> 1.5:1.00	Yes
Adjusted Consolidated EBITDA / Consolidated Fixed Charges			
Consolidated EBITDA	\$8.3 million	=>\$8.0 million	Yes

On January 15, 2014, H.I.G. AERT LLC, the holder of all of the issued and outstanding shares of Series E Convertible Preferred Stock, waived the Specified Events of Default as a result of AERT failing to have achieved a Leverage Ratio of below 3.1 to 1.0 for the four Fiscal Quarters ending December 31, 2013. H.I.G. AERT, LLC also waived the Specified Events of Default as a result of AERT exceeding the maximum capital expenditure requirement of \$2.5

million. In addition, on January 15, 2014, H.I.G. AERT LLC waived its right to deliver a Triggering Event Redemption Notice on the Series E stock solely as a result of the Specified Events of Default.

## 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. Payments of accounts receivable are allocated to the specific invoices identified on the customer's remittance advice. Accounts receivable are carried at the original invoice amount less an estimated reserve. Management reviews all overdue accounts receivable balances and estimates the portion, if any, of the balance that may not be collected and provides an allowance. Balances that remain outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a reduction in trade accounts receivable. Recoveries of trade receivables previously written off are recorded when received.

### Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market. Material, labor, and factory overhead necessary to produce the inventories are included in their cost.

### Buildings and Equipment

Property additions and betterments include capitalized interest and acquisition, construction and administrative costs allocable to construction projects and property purchases. The 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 assess the impairment of long-lived assets, consisting of property, plant, and equipment, whenever events or circumstances indicate that the carrying value may not be recoverable. Examples of such events or circumstances include:

- an asset group's inability to continue to generate income from operations and positive cash flow in future periods;
- loss of legal ownership or title to an asset;
- significant changes in our strategic business objectives and utilization of the asset(s); and
- the impact of significant negative industry or economic trends.

For the year ending December 31, 2013, the Company has determined that there were no events or circumstances indicating the carrying value may not be recoverable.

For purposes of testing impairment, we group our long-lived assets at the same level for which there are identifiable cash flows independent of other asset groups. Currently, there is only one level of aggregation for our assets.

Recoverability of assets to be held and used in operations is measured by a comparison of the carrying amount of our assets to the undiscounted future net cash flows expected to be generated by the assets. The factors used to evaluate the future net cash flows, while reasonable, require a high degree of judgment and the results could vary if the actual results are materially different than the forecasts. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Assets to be disposed of are reported at the lower of the carrying amount or fair value less selling costs.

As stated in Note 2, 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, and machinery and equipment — 3 to 10 years. We also periodically review the lives assigned to our assets to ensure that our initial estimates do not exceed any revised estimated periods from which we expect to realize cash flows from the asset.



## Revenue Recognition

The Company recognizes revenue 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 collectability is reasonably assured. The Company typically recognizes revenue at the time product is shipped or when segregated and billed under a bill and hold agreement. 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.

## Uncertainties, Issues and Risks

There are many factors that could adversely affect our 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, manufacturing inefficiencies, high scrap rates, inability to obtain adequate financing (i.e. working capital), equipment breakdowns, low stock price, and fluctuations in quarterly performance.

## 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 expectations or 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 our 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.

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

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## Item 9A. Controls and Procedures.

### Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer, Timothy D. Morrison, who is our principal executive officer, and our Chief Financial Officer, J. R. Brian Hanna, who is our principal financial and accounting officer, have reviewed and 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 amended (the Exchange Act)) as of December 31, 2013. Based upon this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of December 31, 2013, the end of the period covered by this report, AERT's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by AERT in the reports that it files or submits under the Exchange Act and are effective in ensuring that information required to be disclosed by AERT in the reports that it files or submits under the Exchange Act is accumulated and communicated to AERT's management, including AERT's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

### 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.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2013 using the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the 1992 Internal Control-Integrated Framework. Based on that evaluation, management believes that our internal control over financial reporting was effective as of December 31, 2013.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by its registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit it to provide only management's report in this annual report.

### Changes in Internal Control over Financial Reporting

During the fourth quarter ended December 31, 2013, there have been no changes in our internal controls 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.

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### PART III

#### Item 10. Directors, Executive Officers and Corporate Governance.

The information required by Item 10 is incorporated herein by reference to the Company's definitive proxy statement for its 2014 annual meeting of stockholders.

#### Item 11. Executive Compensation.

The information required by Item 11 is incorporated herein by reference to the Company's definitive proxy statement for its 2014 annual meeting of stockholders.

#### 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 2014 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 2014 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 2014 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 of 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.

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/ timothy d. morrison  
Timothy D. Morrison,  
Chief Executive Officer and Director  
(Principal Executive Officer)

/s/ J. R. BRIAN HANNA  
J. R. Brian Hanna,  
Chief Financial Officer and Principal Accounting Officer

Date: March 6, 2014

POWER OF ATTORNEY

The undersigned directors and officers of Advanced Environmental Recycling Technologies, Inc. hereby constitute and appoint Timothy D. Morrison 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	March 6, 2014
/s/ RANDALL D. GOTTLIEB Randall D. Gottlieb	President	March 6, 2014
/s/BOBBY J. SHETH Bobby J. Sheth	Secretary and Director	March 6, 2014
/s/ JACKSON S. CRAIG Jackson S. Craig	Director	March 6, 2014
/s/ TODD J. OFENLOCH Todd J. Ofenloch	Director	March 6, 2014

/s/ MICHAEL R. PHILLIPS  
Michael R. Phillips

Director

March 6, 2014

/s/ VERNON J. RICHARDSON  
Vernon J. Richardson

Director

March 6, 2014



ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying balance sheets of Advanced Environmental Recycling Technologies, Inc. as of December 31, 2013 and 2012, and the related statements of operations, stockholders' deficit, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Advanced Environmental Recycling Technologies, Inc. as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ HOGANTAYLOR LLP  
Fayetteville, Arkansas  
March 6, 2014

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## ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS  
(in thousands)

	December 31, 2013	December 31, 2012
Assets		
Current assets:		
Cash	\$ 124	\$ 124
Trade accounts receivable, net of allowance of \$44 at December 31, 2013 and \$46 at December 31, 2012	3,090	3,090
Accounts receivable - related party	55	55
Inventories	13,000	13,000
Prepaid expenses	522	522
Total current assets	16,791	16,791
Land, buildings and equipment:		
Land	2,200	2,200
Buildings and leasehold improvements	16,500	16,500
Machinery and equipment	47,500	47,500
Construction in progress	3,900	3,900
Total land, buildings and equipment	70,100	70,100
Less accumulated depreciation	41,500	41,500
Net land, buildings and equipment	28,600	28,600
Other assets:		
Debt issuance costs, net of accumulated amortization of \$634 at December 31, 2013 and \$262 at December 31, 2012	853	853
Other assets	380	380
Total other assets	1,233	1,233
Total assets	\$47,624	\$47,624

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

## ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS  
(in thousands)

	December 31, 2013	December 31, 2012
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable – trade	\$ 3,993	\$ 4,105
Accounts payable – related parties	13	591
Current maturities of long-term debt	1,209	1,195
Accruals related to expected settlement of class action lawsuit	133	1,268
Other accrued liabilities	3,859	4,422
Working capital line of credit	5,135	2,327
Total current liabilities	14,342	13,908
Long-term debt, less current maturities	34,972	33,800
Commitments and Contingencies (See Note 12)		
Series E cumulative convertible preferred stock, \$0.01 par value; 30,000 shares authorized, 20,524 shares issued and outstanding at December 31, 2013 and 2012, including accrued unpaid dividends of \$3,709 and \$2,308 at December 31, 2013 and 2012, respectively	24,233	22,832
Stockholders' deficit:		
Class A common stock, \$.01 par value; 525,000,000 shares authorized; 88,165,632 shares issued and outstanding at December 31, 2013 and 2012	882	882
Class B convertible common stock, \$.01 par value; 7,500,000 shares authorized; 1,465,530 shares issued and outstanding at December 31, 2013 and 2012	15	15
Additional paid-in capital	53,660	53,660
Accumulated deficit	(81,100 )	(79,636 )
Total stockholders' deficit	(26,543 )	(25,079 )
Total liabilities and stockholders' deficit	\$ 47,004	\$ 45,461

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

## ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF OPERATIONS  
(in thousands, except share and per share data)

	Year Ended	
	December 31, 2013	December 31, 2012
Net sales	\$68,779	\$ 74,611
Cost of goods sold	56,976	61,328
Gross margin	11,803	13,283
Selling and administrative costs	11,535	11,070
Gain from asset disposition	(9 )	(38 )
Operating income	277	2,251
Other income and expenses:		
Income from insurance proceeds	2,500	-
Other income	162	52
Other expense	(82 )	-
Net interest expense	(2,920 )	(2,972 )
Net loss	(63 )	(669 )
Dividends on preferred stock	(1,401 )	(1,320 )
Net loss applicable to common stock	\$(1,464 )	\$ (1,989 )
Loss per share of common stock (basic and diluted)	\$(0.02 )	\$ (0.02 )
Weighted average common shares outstanding (basic and diluted)	89,631,162	89,631,162

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

## ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

## STATEMENTS OF STOCKHOLDERS' DEFICIT

(in thousands, except share data)

	Class A Common		Class B Common		Additional		Total
	Stock		Stock		Paid-in Capital	Accumulated Deficit	
	Shares	Amount	Shares	Amount			
Balance - December 31, 2011	88,165,632	\$882	1,465,530	\$15	\$53,347	\$ (77,647 )	\$(23,403)
Related party forgiveness of debt	-	-	-	-	313	-	313
Net loss applicable to common stock	-	-	-	-	-	(1,989 )	(1,989 )
Balance - December 31, 2012	88,165,632	\$882	1,465,530	\$15	\$53,660	\$ (79,636 )	\$(25,079)
Net loss applicable to common stock	-	-	-	-	-	(1,464 )	(1,464 )
Balance - December 31, 2013	88,165,632	\$882	1,465,530	\$15	\$53,660	\$ (81,100 )	\$(26,543)

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

## ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENT OF CASH FLOWS  
(in thousands)

	Year Ended	
	December	December 31,
	31,	2012
	2013	
Cash flows from operating activities:		
Net loss applicable to common stock	\$(1,464 )	\$ (1,989 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	4,649	5,610
Dividends on preferred stock	1,401	1,320
Accrued interest converted to long-term debt	2,362	2,158
Gain from fixed asset impairment and disposition	(9 )	(38 )
Increase in accounts receivable allowance	(2 )	(91 )
Decrease in other assets	32	961
Changes in other current assets and current liabilities	(4,698 )	(6,416 )
Net cash provided by operating activities	2,271	1,515
Cash flows from investing activities:		
Purchases of land, buildings and equipment	(3,376 )	(3,069 )
Proceeds from disposition of equipment	11	18
Net cash used in investing activities	(3,365 )	(3,051 )
Cash flows from financing activities:		
Proceeds from the issuance of notes	-	7,972
Payments on notes	(1,903 )	(3,125 )
Net borrowing (payments) on line of credit	2,807	(3,798 )
Releases from restricted cash	-	881
Increase in restricted cash for payment of debt and construction costs	-	(427 )
Debt issuance costs	(32 )	(704 )
Net cash provided by financing activities	872	799
Decrease in cash	(222 )	(737 )
Cash, beginning of period	346	1,083
Cash, end of period	\$124	\$ 346

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 or the Company), founded in 1988, recycles polyethylene plastic and 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. The Company's products are made primarily from approximately equal amounts of waste wood fiber, which have been cleaned, sized and reprocessed, and recycled polyethylene plastics that have been cleaned, processed, and reformulated utilizing our patented and proprietary technologies. Its products have been extensively tested, and are sold by leading national companies such as BlueLinx Corporation (BlueLinx), Lowe's Companies, Inc. (Lowe's) and Therma-Tru Corporation. The Company's products are primarily used in renovation and remodeling by consumers, homebuilders, and contractors as an exterior environmentally responsible building alternative for decking, railing, and trim products.

The Company's distributor for its ChoiceDek® products is BlueLinx Corporation. All ChoiceDek® products are sold by BlueLinx exclusively to Lowe's.

The Company currently manufactures all of its composite products at extrusion facilities in Springdale, Arkansas. The Company operates a plastic recycling, blending and storage facility in Lowell, Arkansas, where it also leases warehouses and land for inventory storage. The Company also maintains a facility at Watts, Oklahoma where it cleans, reformulates, and recycles polyethylene plastic scrap as a means to reduce the Company's costs of recycled plastics. The Company also leases warehouse space for inventory storage in Westville, Oklahoma.

Note 2: Summary of Significant Accounting Policies

Revenue Recognition

The Company recognizes revenue 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 collectability is reasonably assured. The Company typically recognizes revenue at the time product is shipped or when segregated and billed under a bill and hold agreement. Sales are recorded net of discounts, rebates, and returns, which were \$3.5 million and \$3.9 million in 2013 and 2012, respectively.

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.

Accrued Product Returns

Revenue adjustment estimates are based on the original sales price of the product expected to be returned, transportation to AERT's facility in Springdale, Arkansas, labor and repackaging materials, and costs to dispose of unsalable product. The accrual is reduced by the per pound cost of any unsalable product that can be re-used in the manufacturing process. Replacement deck boards are accounted for as a sale in accordance with our revenue recognition policy.

In December 2011, AERT recognized the probable and estimable loss resulting from the ChoiceDek® inventory refresh. An inventory refresh entails replacing existing deck boards at Lowe's stores with newly designed product that



is expected to enhance future sales. An entry was recorded to recognize an obligation for anticipated product returns and the cost associated with these returns less the recovery of raw materials to be placed back into inventory. The increase to raw materials inventory of \$1.0 million was estimated based on valuation of the returned product as “regrind.” “Regrind” is best described as recyclable manufacturing waste. Our manufacturing process enables us to grind returned product and use it as a raw material. In the production of composite building materials, as much as 50% of the product may consist of “regrind”.

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The accrued liability for product returns at December 31, 2011 was \$4.7 million. The cost assigned to the returned product considered regrind and classified as raw materials inventory was approximately \$1.0 million at December 31, 2011, all of which was utilized in the manufacturing process during 2012.

#### Shipping and Handling

The Company records shipping fees billed to customers in net sales and records the related expenses in cost of goods sold.

#### 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, repairs 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 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 (in thousands):

	Year Ended December 31,	
	2013	2012
Receivables - trade and related party	\$599	\$(1,787 )
Inventories	(3,682 )	1,652
Prepaid expenses	763	-
Accounts payable - trade and related parties	(689 )	(464 )
Accrued liabilities	\$(1,689 )	\$(5,817 )
	\$(4,698 )	\$(6,416 )
Cash paid for interest	\$558	\$819
Cash paid for income taxes	-	-

#### Supplemental Disclosures of Non-cash Investing and Financing Activities (in thousands):

	Year Ended December 31,	
	2013	2012
Notes payable for financing insurance policies	\$727	\$673
Note payable for equipment	-	45
Forgiven related party loan guarantee fees	-	313
Accrued interest converted to long term debt	2,362	2,158



## 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, and machinery and equipment — 3 to 10 years. Depreciation expense recognized by the Company for each of the years ended December 31, 2013 and 2012 was \$4.3 million and \$5.6 million, respectively. Assets under capital leases are reported in buildings and equipment and office equipment and amortized over the shorter of the primary lease term or estimated future lives.

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. Interest costs incurred during periods of construction of facilities are capitalized as part of the project cost. There was no capitalized interest for the years ended December 31, 2013 and 2012.

The Company assesses the recoverability of its 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.

For the year ending December 31, 2013, the Company has determined that there were no events or circumstances indicating the carrying value may not be recoverable.

## Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market. Material, labor, and factory overhead necessary to produce the inventories are included in their cost. Inventories consisted of the following at December 31 (in thousands):

	2013	2012
Parts and supplies	\$385	\$648
Raw materials	4,715	3,935
Work in progress	2,337	2,034
Finished goods	5,713	2,851
	\$13,150	\$9,468

## Other Assets

Debt issuance costs are amortized over the term of the related debt. Debt issuance costs of \$0.37 million for 2013 were charged to amortization expense.

As of December 31, the Company had the following amounts related to intangible assets (in thousands):

	2013		2012	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Debt issuance costs	\$1,487	\$ 634	\$1,455	\$ 262

The following table represents the total estimated future amortization of intangible assets (in thousands):

	Estimated Amortization
2014	\$ 370
2015	329
2016	125
2017	29

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## 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. Payments of accounts receivable are allocated to the specific invoices identified on the customer's remittance advice.

Accounts receivable are carried at original invoice amounts less an estimated reserve provided for returns and discounts based on a review of historical rates of returns and expected discounts. 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 overdue accounts receivable balances 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 an allowance 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.

The table below presents a roll forward of our allowance for sales returns and bad debts for 2013 and 2012 (in thousands).

	Balance at Beginning of Year	Charged to Costs and Expenses	Charged to Other Accounts	Deductions <sup>1</sup>	Balance at End of Year
2013	\$ 47	396	-	400	\$ 43
2012	\$ 137	935	302	1,327	\$ 47

<sup>1</sup>Charges to the accounts are for the purposes for which the reserve was created.

## Warranty Estimates

The Company offers a limited warranty on its products. Estimates of expected warranty claims are recorded as liabilities and charged to income in the period revenue is recognized. Amounts accrued for warranty claims totaled \$0.5 million at December 31, 2013 and \$0.6 at December 31, 2012.

## Earnings Per Share

The Company utilizes the two-class method for computing and presenting earnings per share. The Company currently has two classes of common stock (the Common Stock) and one class of cumulative participating preferred stock, Series E (the Preferred Stock). Pursuant to the Series E Designation, holders of the Series E Preferred Stock are entitled to receive per share dividends equal to 6% per annum of the stated value of \$1,000 per share of Series E Preferred Stock when declared by the Company's Board of Directors. In addition, holders of the Series E Preferred Stock are entitled to participate in any dividends declared on shares of the Company's Common Stock on an as-converted basis. Therefore, the Preferred Stock is considered a participating security requiring the two-class method for the computation and presentation of net income per share – basic.

The two-class computation method for each period segregates basic earnings per common and participating share into two categories: distributed earnings per share (i.e., the Preferred Stock stated dividend) and undistributed earnings per share, which allocates earnings after subtracting the Preferred Stock dividend to the total of weighted average common shares outstanding plus equivalent converted common shares related to the Preferred Stock. Basic earnings

per common and participating share exclude the effect of Common Stock equivalents, and are computed using the two-class computation method.

In computing diluted EPS, only potential common shares that are dilutive—those that reduce earnings per share or increase loss per share—are included. The exercise of options or conversion of convertible securities is not assumed if the result would be antidilutive, such as when a loss from continuing operations is reported. 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 losses from continuing operations for years ended December 31, 2013 and 2012. Therefore, basic EPS and diluted EPS were computed in the same manner. The following table presents the two-class method for the years ended December 31, 2013 and 2012.

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**BASIC EARNINGS PER SHARE**  
(in thousands, except share data)

	Year Ended December 31,	
	2013	2012
Net loss applicable to common stock	\$(1,464 )	\$(1,989 )
Preferred stock dividend	1,401	1,320
Loss before dividends	(63 )	(669 )
Per share information:		
Basic earnings per common and participating share:		
Distributed earnings per share:		
Common	\$0.00	\$0.00
Preferred	\$0.00	\$0.00
Earned, unpaid dividends per share		
Preferred	\$68.26	\$64.32
Undistributed loss per share:		
Common	\$(0.02 )	\$(0.02 )
Preferred	-	-
Total basic earnings (loss) per common and participating share:		
Common	\$(0.02 )	\$(0.02 )
Preferred	\$68.26	\$64.32
Basic weighted average common shares:		
Common weighted average number of shares	89,631,162	89,631,162
Participating preferred shares - if converted	312,938,898	294,850,030
Total weighted average number of shares	402,570,060	384,481,192
Total weighted average number of preferred shares	20,524	20,524



Although not included in a diluted EPS calculation due to being antidilutive, the Company had potentially dilutive securities outstanding at December 31, 2013 and 2012. The following schedule presents antidilutive securities for the years ended December 31.

	2013	2012
Options	-	350,000
Series E preferred stock	323,104,177	304,423,633

Although these financial instruments were not included due to being antidilutive, such financial instruments may become dilutive and would then need to be included with future calculations of diluted EPS.

#### Concentration Risk

#### Credit Risk

The Company's revenues are derived principally from national and regional building products distributors and BlueLinx, the Company's primary decking customer. The ChoiceDek® brand of decking products sold to BlueLinx are in turn sold exclusively to Lowe's. BlueLinx is also one of the Company's MoistureShield® decking customers. 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 Company's customers. For the year ended December 31, 2013, the Company derived 64% of its revenue from BlueLinx, its distributor of ChoiceDek® products compared to 62% for the year ended December 31, 2012.

#### Major Customers

One customer accounted for 78% of accounts receivable at December 31, 2013. At December 31, 2012, one customer accounted for 62% and a second customer accounted for 22% of the accounts receivable. In addition, one international distributor accounted for 10% of our sales in 2013. The Company regularly monitors the creditworthiness of its customers and believes that it has adequately provided for exposure to potential credit losses.

#### Cash

The Company maintains bank accounts which are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. 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 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.

#### Share-Based Payments

The Company measures the cost of employee and director service received in exchange for an award of equity instruments based on the grant-date fair value of the award and recognizes that cost in the financial statements. Compensation cost is recognized as the awards vest. Since 2005, the Company has used restricted stock awards as its exclusive form of stock-based compensation. On March 18, 2011, with the change of control, all stock awards were

vested.

#### 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.

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#### Advertising Costs

Advertising costs are expensed in the period incurred. Advertising expense was \$0.9 million for the year ended December 31, 2013 and \$1.1 million for the year ended December 31, 2012.

#### Research and Development Costs

Expenditures for research activities relating to product development and improvement are charged to expense as incurred. Such expenditures amounted to \$0.4 million and \$0.2 million in 2013 and 2012, respectively.

#### Recent Accounting Pronouncements

Accounting standards that have been issued or proposed that do not require adoption until a future date are not expected to have a material impact on our financial statements upon adoption.

#### Note 3: Related Party Transactions

##### Leases

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 the construction of a waste plastic washing, recycling, and reclamation facility. The property was leased from Razorback Farms, a corporation controlled by Marjorie S. Brooks, a former director, with payments of \$0.0075 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 per month. The throughput or production rent was due quarterly and was capped throughout the term of the lease not to exceed \$450,000 per year. Rent expense recorded under this lease totaled \$188,143 in 2012.

In March 2013, the Company purchased the 60 acres in Adair County from Razorback Watts. As a result of this transaction, no rent expense was recognized in 2013 for this property.

##### Guaranty Agreement

In consideration for Ms. Brooks continuing to perform her obligations under a January 16, 2006 Guaranty Agreement, as amended, in favor of Liberty Bank (the Liberty Guaranty), the Company entered into a Guaranty Fee Agreement with Ms. Brooks, dated March 18, 2011 and February 15, 2012 (the Guaranty Fee Agreement), pursuant to which the Company agreed to pay to Ms. Brooks, for as long as the Liberty Guaranty remained in effect. Concurrent with the execution of the AloStar term loan on November 15, 2012, the Liberty Note was paid in full and the Liberty Guaranty was cancelled.

##### Advisory Services Agreement

The Company also entered into an Advisory Services Agreement between H.I.G. Capital, L.L.C., an affiliate of H.I.G., and the Company (the Advisory Services Agreement) on March 18, 2011 that provides for an annual monitoring fee between \$250,000 and \$500,000 (the Monitoring Fee) and reimbursement of all other out of pocket fees and expenses incurred by H.I.G. Capital, L.L.C.. In addition, pursuant to the terms of the Advisory Services Agreement, H.I.G. Capital, L.L.C. will be entitled to a financial advisory fee and a supplemental management fee in connection with any acquisition, disposition or material public or private debt or equity financing of the Company, in each case which has been introduced, arranged, managed and/or negotiated by H.I.G. Capital, L.L.C. or its affiliates. H.I.G. Capital, L.L.C. was paid a \$500,000 transaction fee under the Advisory Services Agreement in connection with the recapitalization.

The Company recorded advisory services fees of \$0.25 million in 2013 and 2012, respectively, which were related to the Advisory Services Agreement.

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Other

The balance of related party accounts included the following amounts:

- Lease and other charges of \$0.38 million at December 31, 2012 owed to Razorback Farms.
- Accrued board of directors' fees of \$13 thousand at December 31, 2013 and \$14 thousand at December 31, 2012.
- There were no accrued advisory services fees as of December 31, 2013. There were \$0.21 million of accrued advisory services fees as of December 31, 2012 that were owed to H.I.G.
- Accounts receivable from Joe G. Brooks, Chairman, was \$19 thousand at December 31, 2013.
- Accounts receivable from Green Country Recycling, LLC, for whom Joe G. Brooks, Chairman, acts as an advisor was \$36 thousand at December 31, 2013.

Note 4: Line of Credit

AERT has a line of credit (Revolver Loan) agreement with AloStar. The \$8.0 million Revolver Loan is subject to a reserve of \$1.0 million plus a maximum reserve of \$1.0 million or the actual reserve for class action claims (\$0.1 million at December 31, 2013). Interest is assessed at the greater of (a) 1.0% and (b) the LIBOR rate as shown in the Wall Street Journal on such day for United States dollar deposits for the one month delivery of funds in an amount approximately equal to the principal amount of the Revolver Loan for which such rate is being determined plus 4% at December 31, 2013. If the LIBOR cannot be determined, the interest will be calculated using the prime lending rate plus 2%. The interest rate at December 31, 2013 was 5%. The Revolver Loan is secured by 85% of accounts receivable after a reduction for amounts owed by international customers. The Revolver Loan is also secured by 60% of the eligible inventory or 85% of the net orderly liquidation value of the inventory. The Revolver at AloStar had a \$5.1 million balance at December 31, 2013. The proceeds available to draw down on the Revolver loan at December 31, 2013 were \$1.7 million.

## Note 5: Long-Term Debt

	Year Ended	
	December 31, 2013	December 31, 2012
	(in thousands)	
Long-term debt, less current maturities consisted of the following at December 31:		
3% note payable to the Oklahoma Department of Commerce; secured by assets purchased / constructed with the loan proceeds; matures April 1, 2027	2,722	2,886
H.I.G. Series A Note (a)	12,469	11,519
H.I.G. Series B Note (b)	15,015	13,603
AloStar Bank of Commerce Term Loan bearing interest at 5.5%; secured by a continuing security interest in and lien upon all personal proerty, including all goods, inventory, equipment, all instruments, chattel paper, documents, general intangibles, intellectual property, deposit accounts, and investment property	5,917	6,917
Other	58	70
<b>Total</b>	<b>36,181</b>	<b>34,995</b>
Less Current Maturities	(1,209 )	(1,195 )
<b>Long-term debt, less current maturities</b>	<b>\$34,972</b>	<b>\$ 33,800</b>

(a) Cash interest of 4% plus 4% PIK interest added quarterly to principal. Addition occurs after quarter-end. To date all cash interest on H.I.G. Series A Note has been added to principal.

(b) Cash interest of 4% plus 6% PIK interest added quarterly to principal. Addition occurs after quarter-end. To date, all cash interest on H.I.G. Series B Note has been added to principal.

The aggregate maturities of long-term debt as of December 31, 2013 were as follows:

(in thousands)	
Year	Amount
2014	1,209
2015	5,104
2016	188
2017	27,670
2018	191
Thereafter	1,819
	<b>36,181</b>

## Oklahoma Energy Program Loan

On July 14, 2010, we entered into a loan agreement with the Oklahoma Department of Commerce (ODOC) whereby ODOC agreed to a 15-year, \$3.0 million loan to AERT at a fixed interest rate of 3.0%. The loan was made pursuant to the American Recovery and Reinvestment Act State Energy Program for the State of Oklahoma, and funded the second phase of AERT's new recycling facility in Watts, Oklahoma. Payments on the loan began May 1, 2012. The balance on the loan at December 31, 2013 was \$2.7 million.

ODOC, under award number 14215 SSEP09, advanced \$3.0 million to AERT throughout 2010, 2011 and 2012. As of December 31, 2012, a total of \$3.0 million was spent on contract labor, contract materials, and equipment. In addition, as of December 31, 2012, matching funds of \$9.2 million were contributed (in-kind) to the project by AERT.



#### AloStar Bank of Commerce Term Loan

The Term Loan requires that AloStar hold first security interest to the majority of AERT's plant, property, and equipment; as well as, real estate. Payments on the principal portion of the loan commenced on December 1, 2012 and will be made in 36 equal monthly installments of \$0.08 million plus interest. The final installment \$4.1 million shall be due and payable on the commitment termination date. Interest is calculated at 4.5% plus the greater of (a) 1.0% and (b) the LIBOR Rate as shown in the Wall Street Journal on such day for United States dollar deposits for the one month delivery of funds in amounts approximately equal to the principal amount of the Loan for which such rate is being determined or, if such day is not a Business Day on the immediately preceding Business Day. Interest accrued on the principal balance of the Term Loan shall be due and payable on the first day of each month, computed through the last day of the preceding month. Interest, expressed in simple interest terms as of December 31, 2013, is 5.5%.

The Term Loan contains certain covenants, including restrictions on: (1) fundamental changes in ownership, (2) conduct of business, (3) declaration of distributions, (4) amendments or modifications to existing agreements, (5) property acquisitions, (6) affiliated party transactions, and (7) hedging agreements. The proceeds of the loan were used to pay the Liberty Bank obligations.

#### Recapitalization Agreement - H.I.G. Long Term Debt

In connection with the recapitalization, the Company entered into a Securities Exchange Agreement with H.I.G. (the Exchange Agreement), and a Credit Agreement with H.I.G. (the Credit Agreement), each dated March 18, 2011.

Pursuant to the Exchange Agreement and the Credit Agreement, in exchange for the Company's debt:

- \$6,806,656 of principal plus accrued interest owed under the Allstate Promissory Note, dated July 1, 2009, issued by the Company;
  - \$13,281,084 of principal plus accrued interest owed under the Adair County Industrial Authority Solid Waste Recovery Facilities Revenue Bonds issued in 2007;
  - \$10,436,409 of principal plus accrued interest owed under the City of Springdale Arkansas, Industrial Development Refunding Revenue Bonds issued in 2008;
  - \$2,096,667 of principal plus accrued interest owed under the Secured Promissory Note (2010 Note) issued on December 20, 2010;
  - and H.I.G. making approximately \$6.9 million in additional new capital available to the Company,
- H.I.G. was issued:
- a Series A Term Note (Series A Note) in the aggregate principal amount of \$10,000,000,
  - a Series B Senior Term Note (Series B Note, and collectively with the Series A Note, the Notes) in the aggregate principal amount of \$9,000,000 (or such lesser amount as is actually borrowed thereunder),
  - and 20,524,149 shares of Series E Convertible Preferred Stock, par value \$0.01 per share, of the Company (the Series E Preferred Stock).

As a result, upon consummation of the Transactions (including the Series D Exchange Agreement described hereunder), H.I.G. held \$17,596,667 outstanding principal of senior secured debt of the Company and owned approximately 80% of the outstanding common equity securities of the Company on a fully diluted, as converted basis. Pursuant to the Exchange Agreement, until such time as H.I.G. no longer owns at least 20% of the Company's outstanding Common Stock on a fully diluted basis, H.I.G. has the right to purchase securities in any subsequent issuance or sale of securities by the Company in an amount equal to the greater of (i) H.I.G.'s ownership percentage as of the business day prior to its receipt of notice of the proposed issuance or sale by the Company or (ii) 51%.

Pursuant to the Credit Agreement, the Company issued to H.I.G. the Notes, which are secured by a grant of a security interest in all of the Company's assets in accordance with the terms of a Security Agreement, Patent Security Agreement, Copyright Security Agreement and Trademark Security Agreement, each dated March 18, 2011. The Series A Note matures six years after the closing of the Transactions (the Closing) and, at the Company's option, either



(i) bears cash interest at 8.0% per annum or (ii) bears cash interest at 4.0% per annum, plus a rate of interest equal to 4.0% per annum payable in kind and added to the outstanding principal amount of the Series A Note (with the latter option only being available for the first 24 months following the Closing, after which the Series A Note will bear cash interest at 8.0% per annum). This option was extended through 2013.

Upon the Closing, H.I.G. converted the \$2,000,000 principal amount of the 2010 Note and accrued interest thereon into borrowings under the Series B Note. In addition, an additional \$5.5 million was funded and drawn under the Series B Note at Closing. On October 20, 2011 AERT and H.I.G. amended this Credit Agreement to provide the Company with an additional \$3.0 million to be drawn, as needed. The Company drew down \$1.0 million on May 23, 2011, \$2.0 million on October 21, 2011, and \$1.0 million on November 18, 2011 to help fund operations. The Company drew down \$0.5 million on November 5, 2012, which was repaid on November 15, 2012 with the closing of the AloStar term loan. The Series B Note matures six years after the Closing and, at the Company's option, either (i) bears cash interest at 10.0% per annum or (ii) bears cash interest at 4.0% per annum, plus a rate of interest equal 6.0% per annum payable in kind and added to the outstanding principal amount of the Series B Term Note. The Series B Note ranks pari passu to the Series A Note.

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As of December 31, 2013, AERT did not comply with the leverage ratio covenant required by the Series A and B Term Notes. The debt covenant has been waived by H.I.G. per the Waiver of Specified Events of Default as of January 15, 2014.

The Credit Agreement contains provisions requiring mandatory payments upon the Notes equal to 50% of the Company's "Excess Cash Flow" (as defined in the Credit Agreement) and equal to 100% of proceeds from most non-ordinary course asset dispositions, additional debt issuances or equity issuances (subject to certain exceptions in each case or as H.I.G. otherwise agrees), and contains covenant restrictions on the incurrence of additional debt, liens, leases or equity issuances (subject to certain exceptions in each case or as H.I.G. otherwise agrees).

#### Note 6: Equity

##### Series E Cumulative Convertible Preferred Stock

Pursuant to the Exchange Agreement, the Company issued 20,524,149 shares of newly authorized Series E Preferred Stock to H.I.G. at the Closing. The Series E Preferred Stock was authorized by the filing of a Certificate of Designations, Preferences and Rights of the Series E Convertible Preferred Stock of the Company filed on March 17, 2011 with the Delaware Secretary of State (the Series E Designation). Pursuant to the Series E Designation, holders of the Series E Preferred Stock are entitled to receive per share dividends equal to 6% per annum of the stated value of \$1,000 per share of Series E Preferred Stock when declared by the Company's Board of Directors. In addition, holders of the Series E Preferred Stock are entitled to participate in any dividends declared on shares of the Company's Common Stock on an as-converted basis. Shares of the Series E Preferred Stock and all accrued dividends thereon are convertible at any time at the holder's election into shares of the Company's Class A Common Stock (the Conversion Shares) at a conversion price of \$0.075 per share, subject to customary anti-dilution adjustments. The Series E Preferred Stock ranks senior to all other equity securities of the Company. Holders of the Series E Preferred Stock have the right to vote their ownership interests in the Series E Preferred Stock on an as-converted basis. In addition, holders of the Series E Preferred Stock also have the right to elect four of the Company's seven directors while they hold outstanding shares of Series E Preferred Stock representing at least 20% of the outstanding shares of Common Stock on an as-converted basis. If the outstanding shareholding of Series E Preferred Stock at any time represents less than 20% of the outstanding shares of Common Stock on an as-converted basis, the holders of the Series E Preferred Stock will have the right to elect one of the Company's seven directors. The Series E Designation contains customary protective voting provisions and other rights customarily granted to holders of preferred equity securities.

The Series E Convertible Preferred Stock is not redeemable except under certain conditions which may be out of the control of the Company. An event of default under the Series A and B Term notes, for example, the failure to meet specified financial covenants, may trigger a redemption right to the holders of the Series E Convertible Preferred stockholders. As a result, the carrying value of the Series E Convertible Preferred Stock is reported in temporary equity.

On January 15, 2014, H.I.G. AERT LLC, the holder of all of the issued and outstanding shares of Series E Convertible Preferred Stock, waived the Specified Events of Default as a result of AERT failing to have achieved a Leverage Ratio of below 3.1 to 1.0 for the four Fiscal Quarters ending December 31, 2013. H.I.G. AERT, LLC also waived the Specified Events of Default as a result of AERT exceeding the maximum capital expenditure requirement of \$2.5 million. In addition, on January 15, 2014, H.I.G. AERT LLC waived its right to deliver a Triggering Event Redemption Notice on the Series E stock solely as a result of the Specified Events of Default.

The initial conversion price of the Series E Preferred Stock is fixed and will remain the conversion price subject to the anti-dilution adjustments described below. The conversion price of the Series E Preferred Stock is subject to customary weighted-average anti-dilution adjustments, which will be made (subject to certain exceptions) in the event

that AERT:

- issues or sells common stock for consideration per share less than a price equal to the current market price in effect immediately prior to such issue or sale;

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- pays dividends or other distributions on the common stock in shares of common stock;
- subdivides, splits or combines the shares of common stock;
- subject to certain exceptions and limitations, issues options, rights or warrants entitling the holders to purchase common stock at less than the then-current market price (as defined in the certificate of designations for the Series E Preferred Stock);
- issues or sells any securities that are convertible into or exercisable or exchangeable for common stock and the lowest price per share for which one share of common stock is issuable upon the conversion, exercise or exchange thereof is less than the then-current market price;
- makes changes to the terms of outstanding options, warrants, or convertible securities (including those that were outstanding as of March 18, 2011, the original issue date of the Series E Preferred Stock) and that would result in a dilutive effect on the Series E Preferred Stock; in general, in such event the adjustment shall be calculated as if the changed terms had been in effect from the initial issuance of such securities and such securities issued before March 18, 2011 shall be treated as if newly issued as of the date of such change; provided that no adjustment will be made in such case if such adjustment would result in an increase in the conversion price then in effect; and
- takes any action that would result in dilution of the Series E Preferred Stock but is not specifically provided for in the Series E Preferred Stock certificate of designations (including granting of stock appreciation rights, phantom stock rights or other rights with equity features), in which case the Company's Board of Directors shall in good faith determine and implement an appropriate adjustment in the conversion price so as to protect the rights of the holders of the Series E Preferred Stock, subject to certain qualifications.

#### 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.

#### Note 7: Stock Option Plans

Additional stock options are not issuable under the Company's stock option plans, as the plans and any outstanding options have expired.

	2013			2012	
	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value at December 31, 2013	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	350,000	\$ 1.17		525,000	\$ 1.62
Granted	-	-		-	-
Exercised	-	-		-	-
Forfeited	(350,000)	1.17		(175,000)	2.53
Outstanding, end of year	-	\$-	\$-	350,000	\$ 1.17
Exercisable, end of year	-	\$-	\$-	350,000	\$ 1.17

Note 8: Equity Incentive Plans

The Company's 2012 Stock Incentive Plan (Plan) is an equity-based incentive compensation plan that is used to distribute Awards to qualified employees, thereby fulfilling the following objectives of the Company:

1. To enhance the Company's ability to attract highly qualified personnel
2. To strengthen the Company's retention capabilities
3. To enhance the long-term performance and competitiveness of the Company

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4. To align the interest of Plan participants with those of the Company's shareholders.

The Plan was approved by the Board of Directors on March 3, 2012 and by the Shareholders at the 2012 Shareholders' Meeting held in Springdale, Arkansas on June 27, 2012.

#### Administration

The 2012 Plan is administered by the Compensation Committee (Committee) 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. Except when the entire board is acting as the 2012 Plan Administrator, the Committee administering the 2012 Plan shall consist solely of two or more persons all of whom are both "non-employee directors" within the meaning of Rule 16b-3 under the Securities Exchange Act of 1934.

#### Plan Basics

A total of 40,000,000 shares are available for issuance under the Plan. The shares deliverable pursuant to Awards shall be authorized but unissued shares, or shares that the Company otherwise holds in treasury or trust. Participants are solely responsible for taxes due on Awards. Awards may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution. In the event of a change of control, shares will be equitably adjusted. Awards will be assumed by the successor company; the Awards Committee may accelerate vesting, arrange for cash payment, terminate all or some Awards, or make other modifications. Pursuant to the Awards Agreement, the Company may terminate, rescind, or recapture any outstanding, unexercised, unexpired, unpaid, or deferred Awards. The Company may require that any Participant reimburse the Company for all or any portion of the Awards granted under this Plan. No Participant shall have any rights as a shareholder of the Company until the date of issuance of a share certificate. The Plan will be valid for a period of 10 years.

The Committee will have the power and authority to select and grant to participants the following types of Awards:

1. Options give the Participant the right to purchase Company stock at a given price over an extended period of time. Incentive Stock Options (ISOs) are within the definition of IRS §422. In the case of an ISO granted to a Participant who is a 10% shareholder on the grant date, the exercise price shall be at least 110% of the fair market value.
2. Share Appreciation Rights (SARs) provide the Participant with a cash (or shares) payment based on the increase in the value of a stated number of shares over a specific period of time. A participant may wish to use an IRS §83(b) election, which will allow the Participant to recognize the value of the SARs as income upon the purchase of the stock.
3. Restricted Shares and Restricted Share Units (RSUs) are shares of stock for which a Participant is eligible after certain restrictions are fulfilled. Restrictions are pursuant to the Awards Agreement. The Participant shall receive unrestricted shares (or cash) in settlement of the Award. Restricted Shares, RSUs and Unrestricted Shares are not inconsistent with the Plan. If the shares are purchased and forfeited for any reason, the purchase price is refunded to the Participant and the shares of stock remain with the Company.
4. Deferred Stock Units (DSUs) are permitted within the Plan guidelines. The Committee may permit select eligible persons who are Directors or members of a select group of management or highly compensated employees (within the meaning of ERISA) to irrevocably elect to forego the receipt of cash or other compensation in lieu thereof to have the Company credit to an internal Plan account the number of DSUs deferred. DSUs are 100% vested at all times.

- 5.

Performance and cash-settled Awards are based on achievement of performance measures for a performance period in relation to a performance formula. The maximum Award will be 10,000,000 shares or \$1.0 million. The Committee may defer the Award.

6. Dividend Equivalent Rights give the Participant the right to receive a payment, in shares or in cash that is equivalent to the value of dividends declared on shares as of all dividend payment dates. The Award is paid on the record date of dividends and is pursuant to the Awards Agreement.

As of December 31, 2013, no awards have been made.

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## Note 9: Leases

At December 31, 2013, the Company was obligated under various operating leases covering certain buildings and equipment that expire between 2014 and 2016. Rent expense under operating leases for the years ended December 31, 2013 and 2012 was \$2.8 million and \$3.1 million, 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 durations of less than one year.

During 2010, the Company also leased certain ERP software, computer equipment, and production equipment under three individual, non-cancelable capital leases. The leases have various terms but all include a bargain purchase option upon expiration. The computer equipment lease expired in 2010 while the software and production equipment leases expired in 2012.

Future minimum lease payments required under operating leases as of December 31, 2013, are as follows (in thousands):

Year	Operating Leases
2014	\$ 1,519
2015	806
2016	391
Total minimum payments required	\$ 2,716

## Note 10: Income Taxes

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 had no income tax provision for State and Federal income for the years ended December 31, 2013 and 2012.

The income tax provisions for 2013 and 2012 differ from the amounts computed by applying the US federal statutory rate of 34% to income as a result of the following (in thousands):

	2013		2012	
	Amount	Percent	Amount	Percent
Income tax at the U.S. federal statutory rate	\$(21 )	34.0	\$(227 )	34.0
Permanent differences	58	(93.0 )	17	(3.0 )
Change in valuation allowance	(37 )	59.0	210	(31.0 )
	\$-	0.0	\$-	0.0



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

	2013		2012	
	Current	Long-Term	Current	Long-Term
Deferred tax assets —				
Net operating loss carryforwards	\$-	\$ 8,786	\$-	\$ 8,757
Accrued expenses	811	-	956	-
Valuation allowance	(1,078 )	(8,738 )	(1,101 )	(7,827 )
Other	471	48	363	51
Total deferred tax assets	204	96	218	981
Deferred tax liability —				
Depreciation	-	96	-	981
Prepaid expenses	204	-	218	-
Total deferred tax liabilities	204	96	218	981
Net deferred tax	\$-	\$ -	\$-	\$ -

As of December 31, 2013, the Company had net operating loss (NOL) carryforwards for federal income tax purposes, which are available to reduce future taxable income. If not utilized, the NOL carryforwards will expire between 2017 and 2031. In March 2011, H.I.G. AERT, LLC acquired a controlling interest in the Company, which resulted in a significant restriction on the utilization of the Company's net operating loss carryforwards. It is estimated that the utilization of future NOL carryforwards will be limited (per IRC 382) to approximately \$0.8 million per year for the next 18 years. The impact of this limitation is approximately \$27.0 million in NOL's, which will expire before the Company can use them.

As there is insufficient evidence that the Company will be able to generate adequate future taxable income to enable it to realize its net operating loss carryforwards prior to expiration, the Company maintains a valuation allowance to recognize its deferred tax assets only to the extent of its deferred tax liabilities.

Based upon a review of its income tax filing positions, the Company believes that its positions would be sustained upon an audit and does not anticipate any adjustments that would result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded. The Company recognizes interest related to income taxes as interest expense and recognizes penalties as operating expense.

The Company is subject to routine audits by various taxing jurisdictions. The recent examination by the Internal Revenue Service of the Company's 2010 federal tax return yielded changes that did not affect the tax that was reported on the return; therefore, the Service has accepted the return. The Company is no longer subject to income tax examinations by taxing authorities for years before 2010, except in the States of California and Texas, for which the 2009 tax year is still subject to examination.

#### Note 11: Business Interruption

On July 17, 2013, the Company experienced a fire at its Springdale North extrusion facility and a silo fire on July 25, 2013, at its Lowell facility. These facilities were closed temporarily while the Company, local, state, and federal officials investigated and repairs were made. The Lowell plant re-commenced operations on July 30, while the first line at the extrusion plant re-commenced production on August 16. The remaining four extrusion lines were brought back into operation between August 17 and August 23, 2013. Final adjustments and repairs to the extrusion lines are still in progress.

The Company included the \$2.5 million insurance advance received in partial settlement of the Springdale fire in October 2013, as other income on the Statement of Operations. AERT has not yet filed a claim for the damage to property sustained in the Springdale fire. AERT submitted a preliminary claim for business interruption. The Company expects to file a claim for the business interruption portion in the first quarter of 2014. A claim for the real and personal property will be filed later in 2014. Although our insurance underwriters have yet to finalize their determination as to the nature of the loss, because a claim was not filed for property damage as of December 31, 2013, the Company determined that the full amount of the proceeds received in October 2013 related to business interruption. It is our belief that the majority of the settlement will be as a result of business interruption.

#### Note 12: Commitments and Contingencies

##### Long Term Contracts

The Company had two agreements for the purchase of raw materials. One agreement expires in three years. The other agreement expired in mid-January 2013, at which time that agreement reverted to a month-to-month obligation.

##### Legal Proceedings

AERT is involved from time to time in litigation arising from the normal course of business that is not disclosed in its filings with the SEC. In management's opinion, this litigation is not expected to materially impact the Company's results of operations or financial condition.

##### Advanced Environmental Recycling Technologies, Inc. v. Ross Systems, Inc.

The Company and Ross Systems, Inc. settled the cause of action that was brought by the Company against Ross Systems, Inc. The parties agreed to keep the terms of the settlement confidential and the Company continues to use Ross software with maintenance from Ross Systems, Inc. The net settlement recovery in 2012 was offset against manufacturing and administrative costs previously incurred.

##### Class Action Lawsuits

The U.S. District Court, Western District of Washington (Seattle Division) approved a class action settlement in January 2009 related to a purported class action lawsuit seeking to recover on behalf of purchasers of ChoiceDek® composite decking for damages allegedly caused by mold and mildew stains on their decks. The settlement includes decking material purchased from January 1, 2004 through December 31, 2007, along with decking material purchased after December 31, 2007 that was manufactured before October 1, 2006, the date a mold inhibitor was introduced into the manufacturing process.

In 2008, the Company accrued an estimated \$2.9 million for resolving claims. In the third quarter of 2009, the Company increased its estimate of costs to be incurred in resolving claims under the settlement by \$5.1 million. The estimate was revised due to events that occurred and information that became available after the second quarter of

2009 concerning primarily the number of claims received. The deadline for submitting new claims has now passed. The claim resolution process has an annual net cost limitation to the Company of \$2.0 million until the claim resolution process is completed.

At December 31, 2013, the Company had a total remaining balance in accrued expenses of \$0.1 million associated with the settlement of the class action lawsuit. The decrease in the accrual is due to claims settlements during 2013.

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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 discretionary-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 approved a discretionary match of \$19 thousand during the year ended December 31, 2013.

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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, Certificate of Amendment filed September 23, 2010, Certificate of Amendment filed July 14, 2011, and Certificate of Correction of the Certificate of Amendment filed on April 27, 2012
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)
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	Loan Agreement between Oklahoma Department of Commerce and Advanced Environmental Recycling Technologies, Inc. dated July 1, 2010 (d)
10.3	Promissory Note between Oklahoma Department of Commerce and Advanced Environmental Recycling Technologies, Inc. dated July 1, 2010 (d)
10.4	Securities Exchange Agreement between Registrant and Investors named therein (H.I.G. AERT, L.L.C.) dated March 18, 2011 (e)
10.5	Series D Preferred Stock Exchange Agreement between Registrant and Stockholders named therein dated March 18, 2011 (e)
10.6	Advisory Services Agreement between Registrant and H.I.G. Capital, L.L.C. dated March 18, 2011 (e)
10.7	Voting Agreement by and among Registrant and the persons named therein, dated March 18, 2011 (e)
10.8	Indemnity Agreement between the Registrant and Michael Phillips dated March 18, 2011 (e)
10.9	Credit Agreement between the Registrant and H.I.G. AERT, L.L.C. as Administrative Agent (e)
10.10	Series A Term Note of Registrant payable to H.I.G. AERT, L.L.C. dated March 18, 2011 (e)
10.11	Series B Term Note of Registrant payable to H.I.G. AERT, L.L.C. dated March 18, 2011 (e)
10.12	Security Agreement between Registrant and H.I.G. AERT, L.L.C. as Administrative Agent dated March 18, 2011 (e)
10.13	Lease Reinstatement, Settlement and Waiver Agreement between Registrant and Banc of America Leasing & Capital, LLC dated March 17, 2011 (e)
10.14	Registration Rights Agreement between Registrant and H.I.G. AERT, L.L.C. (e)
10.15	Loan Agreement between AloStar Bank of Commerce and AERT dated November 15, 2012 (f)
10.16	Subordination Agreement between AloStar Bank of Commerce and H.I.G. AERT, L.L.C. (g)
10.17	H.I.G. Waiver of Default dated January 25, 2013 (g)
10.18	H.I.G. Waiver of Triggering Event dated February 20, 2013 (g)
10.19	Waiver of Default – H.I.G. Credit Agreement dated January 15, 2014**
10.20	Waiver of “Special Events Defaults” per Series A Term Loan Interest dated January 15, 2014**
10.21	Waiver of “Special Events Defaults” per Series E Convertible Preferred Stock Rights dated January 15, 2014**
23.1	Consent of Independent Registered Public Accounting Firm**
31.1	Certification per Sarbanes-Oxley Act of 2002 (Section 302) by the Company’s chief executive officer and director**
31.2	Certification per Sarbanes-Oxley Act of 2002 (Section 302) by the Company’s chief financial officer and principal accounting officer**

Exhibit No.	Description of Exhibit
101.IN	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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\*\* Filed herewith.

- (a) Incorporated by reference to exhibits to Registration Statement on Form S-1, No. 33-29595, filed June 28, 1989.
- (b) Incorporated by reference to exhibits to Amendment No. 1 to Registration Statement on Form S-1, No. 33-29595, filed August 24, 1989.
- (c) Incorporated by reference to exhibits to Amendment No. 2 to Registration Statement on Form S-1, No. 33-29595, filed November 8, 1989.
- (d) Incorporated by reference to exhibits to Form 10-K for December 31, 2011 filed March 30, 2012
- (e) Incorporated by reference to exhibits to Form 8-K filed March 18, 2011
- (f) Incorporated by reference to exhibits to Form 8-K filed November 16, 2012
- (g) Incorporated by reference to exhibits to Form 10-K for December 31, 2012 filed on March 15, 2013