ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC
Form 10-K
March 05, 2015

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

Form 10-K

þ	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the fiscal year ended December 31, 2014 Or
o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-10367
Advanced Environmental Recycling Technologies, Inc.
(Exact name of Registrant as specified in its charter)

Delaware (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 o No x

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 o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark 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 x No o

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. o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o	Smaller reporting company x
(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 o No x

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 $8,852,922 (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, 2015: Class A — 89,631,162

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our Definitive Proxy Statement for our 2015 annual meeting scheduled to be held on June 18, 2015, 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.

We currently manufacture all of our composite products at extrusion facilities in Springdale, Arkansas. We operate a plastic recycling, blending and storage facility in Lowell, Arkansas, where we also lease warehouses and land for inventory storage. We also operate a plastic recycling, cleaning, and reformulation facility at Watts, Oklahoma.

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 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.
- Since 2006, our products have 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 and 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 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.

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, approximately 50%, from BlueLinx (our distributor for ChoiceDek® products) in 2014. 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 approximately 10% of our sales in 2014. 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. New for 2014 was our MoistureShield® Pro—our new cap stock line. MoistureShield® Pro, adds an extra layer of protection and beauty. Essentially, it is our already durable Vantage board with a smooth, protective covering with enhanced slip and scratch resistance. As with all of AERT's products, it can be installed on the ground, in the ground or in the water. MoistureShield® Pro carries with it a transferrable lifetime warranty and a 25-year fade and stain warranty.

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 decking products is highly segmented. 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.

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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.

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, 2014 we had 397 compared to 415 employees at December 31, 2013.

Available Information

We post on our website (www.aert.com) our periodic reports filed with the SEC on Forms 10-K, 10-Q, and 8-K and amendments to these reports filed 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.

We operate a wet plastics recycling facility in Watts, Oklahoma. AERT leased a warehouse in Westville, Oklahoma for inventory storage, but terminated the lease at that location in June 2014 as the additional space was no longer required.

The recycling and extrusion facilities typically operate continuously with occasional shutdowns for holidays and maintenance. We are constantly searching for improvements and efficiencies to our production process and are exploring alternative recycling technology at our Lowell facility.

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, 2014, there were approximately 1,359 holders of record of our Class A common stock and no holders of record of our Class B common stock. The closing price of our common stock was $0.08 on December 31, 2014. 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, 2013 and 2014.

Sales Price Range of Class A Common Stock

Fiscal 2013	High	Low
First Quarter	0.24	0.09
Second Quarter	0.22	0.18
Third Quarter	0.19	0.12
Fourth Quarter	0.15	0.10

Fiscal 2014	High	Low
First Quarter	0.17	0.11
Second Quarter	0.16	0.11
Third Quarter	0.15	0.06
Fourth Quarter	0.12	0.08

No repurchases of common stock took place during 2013 or 2014.

Equity Compensation Plan Information

The following table provides information as of December 31, 2014, regarding shares outstanding and available for issuance under the Company's equity compensation plans. No awards were made in 2014 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.

2014 Summary

Results of Operations
Two-Year Comparison (in thousands)

	2014	2013	% Change
Net sales	$ 75,999	$ 68,779	10.5 %
Cost of goods sold	60,896	56,976	6.9 %
% of net sales	80.1 %	82.8 %	
Gross margin	15,103	11,803	28.0 %
% of net sales	19.9 %	17.2 %	
Gain from asset disposition	69	9	*
Selling and administrative costs	11,964	11,535	3.7 %
% of net sales	15.7 %	16.8 %	
Operating income	3,208	277	1058.1 %
% of net sales	4.2 %	0.4 %	
Other income and expense:			
Income from insurance proceeds	345	2,500	(86.2 %)
Other income	12	80	(85.0 %)
Net interest expense	(3,154)	(2,920)	8.0 %
Gain or (loss) before dividends	411	(63)	*
% of net sales	0.5 %	(0.1 %)	
Dividends on preferred stock	(1,487)	(1,401)	6.1 %
Net loss applicable to common stock	$ (1,076)	$ (1,464)	(26.5 %)
% of net sales	(1.4 %)	(2.1 %)	

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* Not meaningful as a percentage change

Sales

Net sales for the year ended December 31, 2014 were up 10.5% from the year ended December 31, 2013. Lost production as a result of a fire on July 17, 2013 at the extrusion facility in Springdale negatively impacted sales in the second half of 2013. Net sales for 2014 represent a 2% increase over 2012 net sales. In 2014, MoistureShield® sales include the introduction of our new cap stock product, MoistureShield® Pro.

Cost of Goods Sold and Gross Margin

Cost of goods sold increased 6.9% for the year ended December 31, 2014 compared to 2013. As a percentage of sales, 2014 cost of goods sold was 2.7 percentage points lower than 2013, reflecting increased production in 2014 resulting in reduced cost of labor and overhead per unit produced. As a result of the fire in 2013, direct labor costs were higher due to the retention of our skilled labor force during the time of lost production.

Selling and Administrative Costs

Selling and administrative costs were up 3.7% in 2014 compared to 2013. This increase is primarily due to increased advertising, promotions and commissions as a result of increased sales.

As a percentage of sales, selling and administrative costs were down 1.1% from 2013. The primary components of selling and administrative costs are compensation and benefits, advertising and promotion, travel, professional fees, and commissions.

Income from Insurance Proceeds

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, 2013 while the first line at the extrusion plant re-commenced production on August 16, 2013. 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 were completed during the first quarter of 2014.

Estimated costs for personal and real estate damage at the Springdale facility are between \$0.5 million and \$1.0 million. Our estimate is that we will require an additional investment of \$2.9 to \$3.5 million. In 2014, we began the first phase of the facility upgrade, investing \$0.7 million for enhanced worker safety. We feel that we have adequate insurance to cover any and all repairs needed as a result of the fire. A final settlement has not been reached.

Damage sustained at the Lowell facility was predominately one silo, its contents, and related infrastructure. Recovery of \$345 thousand for damages to the Lowell facility was received in the first quarter of 2014.

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 filed a preliminary claim for the damage to property sustained in the Springdale fire and a separate preliminary claim for business interruption caused by the fire in mid-2014. Although our insurance underwriters have yet to finalize their determination as to the nature of the loss and because a claim had not been filed for property damage in 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.

Interest costs were up 8.0% year-over-year primarily due to the paid in kind (PIK) interest on the H.I.G. Series A and Series B notes that increased the principal.

Net Income (Loss)

AERT generated operating income of \$3.2 million for 2014. After consideration of the insurance proceeds for the Lowell fire, dividend and interest expense, the Company had a net loss of \$1.1 million, an improvement of \$0.4 million over 2013.

Liquidity and Capital Resources

The Revolver Loan with AloStar Bank of Commerce is used to cover operating expenses as needed. At December 31, 2014, \$3.4 million was available for drawdown.

The Company plans to structure its operations to grow its business, improve its margins and generate net income for 2015 in order to maximize shareholder value. The Company is currently working to improve its liquidity by:

- Streamlining operations to increase efficiencies: The Company expects to make changes to certain operational processes in order to increase productivity. These changes include the installation of equipment to reduce process material handling costs and manufacturing equipment that will improve yields. The Company is constantly evaluating its recycling processes and opportunities to utilize new technologies.

- Seeking additional sources of revenue: The Company is pursuing additional distribution of its current product lines with new distributors and is introducing new products, including deck lighting and aluminum railing systems, in order to increase its sales.

Cash Flows

Cash Flows from Operations

Cash provided by operations for the year ended December 31, 2014 was $4.2 million, an increase of $1.9 million from the year ended December 31, 2013. This change is primarily due to a change in current assets and liabilities of $2.0 million due to the following:

- Accounts receivable increased $1.3 million in 2014 compared to a decrease of $0.6 million in 2013 due to increased sales.
- 2014 inventory levels increased $1.2 million compared to an increase of $3.7 million in 2013 due to an increase in sales in 2014.
- Accounts payable increased $0.6 million in 2014 compared to a decrease of $0.7 million in 2013 due to increased purchases related to increased production.
- Prepaid expense increased $0.6 million in 2014 compared to a decrease of $0.8 million in 2013 due to higher property insurance premiums.
- Accrued liabilities decreased $0.1 million in 2014 compared to a decrease of $1.7 million in 2013 due to settlement of class action claims in 2013.

Changes to our revenue and cost of raw materials significantly impact the Company's liquidity. We are in the remodeling industry that was 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 two customers representing approximately 52% and 10%, respectively, of our revenue. A loss of these customers, or a major reduction in their business, would cause a significant reduction in our liquidity. We are currently working to broaden our distribution network by adding new distributors, which would reduce our customer concentration.

Cash Flows from Investing Activities

Cash used in investing activities in 2014 was $1.6 million compared to cash used in investing activities of $3.4 million for 2013. This change was primarily due to decreased capital expenditures offset by insurance proceeds from the Lowell fire of 2013 that were recovered in 2014.

Cash Flows from Financing Activities

Cash used in financing activities was $2.6 million for 2014 compared to cash provided by financing activities of $0.8 million in 2013. The change was primarily due to changes in the line of credit and increased proceeds from notes relating to increased insurance premiums.

Working Capital

The Company had working capital of $2.6 million for each of the years ending December 31, 2014 and 2013. Current assets increased by $3.0 million over 2013. The company increased inventory in anticipation of selling ChoiceDek® directly to Lowe's. The current asset increase also reflects a higher accounts receivable balance due to sales growth. Current liabilities increased $3.0 million primarily due to the AloStar term loan maturing in 2015 offset by a reduction in the AloStar line of credit.

Property, Plant and Equipment

The changes in our property, plant, and equipment for 2014 are due primarily to fixed asset additions to our Springdale, Arkansas extrusion facilities. We invested $1.5 million in our new capstock extrusion line and $0.7 million for improvements related to worker safety.

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 $3.6 million at December 31, 2014. The amount available for draw down at December 31, 2014 was $3.4 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, 2014 was $2.6 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, 2014		Compliance
AloStar Bank of Commerce Debt Covenants	Actual	Required	
Capital Expenditures	$ 2.1	<$3.5 million	Yes
Fixed Charge Coverage Ratio	2.19	> 1.10:1.00	Yes
Adjusted Consolidated EBITDA / Consolidated Fixed Charges			
Adjusted EBITDA	$8.3 million	= >$6.0 million	Yes

	Year ended December 31, 2014		Compliance
H.I.G. Debt Covenants	Actual	Required	
Capital Expenditures	$ 2.1	< $2.5 million	Yes
Leverage Ratio	5.0	<= 3.1:1.00	No, Waived
Consolidated Indebtedness / Consolidated EBITDA			
Fixed Charge Coverage Ratio	2.3	> 1.5:1.00	Yes
Adjusted Consolidated EBITDA / Consolidated Fixed Charges			
Consolidated EBITDA	$8.3 million	=>$9.5 million	No, Waived

On January 13, 2015, 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, 2014. H.I.G. AERT, LLC also waived the Specified Events of Default as a result of AERT having failed to attain required EBITDA of $9.5 million. In addition, on January 13, 2015, 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. Payment of cash interest was waived until January 1, 2015.

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, which provides reasonable assurance that inventory values are presented at their current utility. Material, labor, and factory overhead necessary to produce the inventories are included in 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.

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. 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. If a change were to occur in any of the above-mentioned factors or estimates, the likelihood of a material change in our reported results would increase.

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.

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 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, 2014, the Company has determined that the estimated fair value substantially exceeds the carrying value of all long-lived assets.

We are constantly searching for improvements and efficiencies to our production process and are exploring alternative recycling technology at the Lowell facility. Although no changes have been made or approved, any significant modifications to the process could potentially result in a future impairment of assets currently used in operations if the new technology is successfully implemented.

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-Q 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 expectat 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

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, 2014. Based upon this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of December 31, 2014, 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 AERT, 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, 2014 using the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the 2013 Internal Control-Integrated Framework. Based on that evaluation, management believes that our internal control over financial reporting was effective as of December 31, 2014.

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, 2014, 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.

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 2015 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 2015 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 2015 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 2015 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 2015 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 5, 2015

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 5, 2015
/s/ RANDALL D. GOTTLIEB Randall D. Gottlieb	President	March 5, 2015
/s/BOBBY J. SHETH Bobby J. Sheth	Secretary and Director	March 5, 2015
/s/ JACKSON S. CRAIG Jackson S. Craig	Director	March 5, 2015
/s/ TODD J. OFENLOCH Todd J. Ofenloch	Director	March 5, 2015

/s/ MICHAEL R. PHILLIPS Michael R. Phillips	Director	March 5, 2015
/s/ VERNON J. RICHARDSON Vernon J. Richardson	Director	March 5, 2015

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

INDEX TO FINANCIAL STATEMENTS

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, 2014 and 2013, 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, 2014 and 2013, 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 5, 2015

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS
(in thousands)

Assets	December 31, 2014	December 31, 2013
Current assets:		
Cash	$112	$124
Trade accounts receivable, net of allowance of $48 at December 31, 2014 and $44 at December 31, 2013	4,346	3,095
Accounts receivable - related party	26	55
Inventories	14,316	13,150
Prepaid expenses	1,134	522
Total current assets	19,934	16,946
Land, buildings and equipment:		
Land	2,220	2,220
Buildings and leasehold improvements	17,019	16,972
Machinery and equipment	52,267	47,479
Construction in progress	662	3,962
Total land, buildings and equipment	72,168	70,633
Less accumulated depreciation	45,080	41,808
Net land, buildings and equipment	27,088	28,825
Other assets:		
Debt issuance costs, net of accumulated amortization of $1,004 at December 31, 2014 and $634 at December 31, 2013	483	853
Other assets	380	380
Total other assets	863	1,233
Total assets	$47,885	$47,004

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

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS
(in thousands)
(continued)

	December 31, 2014	December 31, 2013
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable – trade	$4,559	$3,993
Accounts payable – related parties	25	13
Current maturities of long-term debt	5,240	1,209
Accruals related to expected settlement of class action lawsuit	-	133
Other accrued liabilities	3,865	3,859
Working capital line of credit	3,625	5,135
Total current liabilities	17,314	14,342
Long-term debt, less current maturities	32,470	34,972
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, 2014 and 2013, including accrued unpaid dividends of $5,196 and $3,709 at December 31, 2014 and 2013, respectively	25,720	24,233
Stockholders' deficit:		
Class A common stock, $.01 par value; 525,000,000 shares authorized; 89,631,162 shares issued and outstanding at December 31, 2014 and 88,165,632 shares issued and outstanding at December 31, 2013	897	882
Class B convertible common stock, $.01 par value; 7,500,000 shares authorized; no shares were issued or outstanding at December 31, 2014; 1,465,320 shares were issued and outstanding at December 31, 2013	-	15
Additional paid-in capital	53,660	53,660
Accumulated deficit	(82,176)	(81,100)
Total stockholders' deficit	(27,619)	(26,543)
Total liabilities and stockholders' deficit	$47,885	$47,004

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

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.