

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC
Form 10-Q
May 17, 2010

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

FORM 10-Q

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

For the quarterly period ended March 31, 2010

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 or other jurisdiction of
incorporation or organization)

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

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

72764
(Zip Code)

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

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES: NO:

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
Non-accelerated filer

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 Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of May 14, 2010, the number of shares outstanding of the Registrant's Class A common stock, which is the class registered under the Securities Exchange Act of 1934, was 48,105,554 and the number of shares outstanding of the Registrant's Class B Common Stock was 1,465,530.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

Form 10-Q Index

PART I — FINANCIAL INFORMATION

		Page
<u>Item 1.</u>	<u>Financial Statements.</u>	
	<u>Balance Sheets, December 31, 2009 and March 31, 2010 (unaudited).</u>	<u>1</u>
	<u>Statements of Operations (unaudited) Three Months Ended March 31, 2009 and 2010.</u>	<u>3</u>
	<u>Statements of Cash Flows (unaudited) Three Months Ended March 31, 2009 and 2010.</u>	<u>4</u>
	<u>Notes to Financial Statements.</u>	<u>5</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	<u>11</u>
<u>Item 4.</u>	<u>Controls and Procedures.</u>	<u>14</u>
PART II — OTHER INFORMATION		
<u>Item 1.</u>	<u>Legal Proceedings.</u>	<u>14</u>
<u>Item 6.</u>	<u>Exhibits.</u>	<u>14</u>
<u>Signatures</u>		<u>15</u>
<u>Index to Exhibits</u>		<u>16</u>

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS

(in thousands, except share and per share data)

Assets	December 31, 2009	March 31, 2010 (unaudited)
Current assets:		
Cash and cash equivalents	\$ 243	\$ 1,088
Trade accounts receivable, net of allowance of \$7 at December 31, 2009 and \$61 at March 31, 2010	5,163	3,269
Inventories	6,795	7,888
Prepaid expenses	707	322
Total current assets	12,908	12,567
Land, buildings and equipment:		
Land	1,989	1,989
Buildings and leasehold improvements	8,903	17,903
Machinery and equipment	45,296	54,102
Transportation equipment	830	803
Office equipment	2,396	2,396
Construction in progress	16,006	52
Total land, buildings and equipment	75,420	77,245
Less accumulated depreciation	36,240	37,450
Net land, buildings and equipment	39,180	39,795
Other assets:		
Debt issuance costs, net of accumulated amortization of \$1,538 at December 31, 2009 and \$1,590 at March 31, 2010	2,941	2,888
Debt service reserve fund	222	222
Other assets, net of accumulated amortization of \$478 at December 31, 2009 and \$486 at March 31, 2010	1,087	1,019
Total other assets	4,250	4,129
Total assets	\$ 56,338	\$ 56,491

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

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS

(in thousands, except share and per share data)

	December 31, 2009	March 31, 2010 (unaudited)
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable – trade	\$ 9,078	\$ 9,958
Accounts payable – related parties	636	706
Current maturities of long-term debt	2,878	2,857
Current maturities of capital lease obligations	244	233
Accruals related to expected settlement of class action lawsuit	7,245	7,130
Other accrued liabilities	6,578	6,344
Working capital line of credit	7,829	7,829
Notes payable	1,238	1,023
Total current liabilities	35,726	36,080
Long-term debt, less current maturities	28,260	28,257
Capital lease obligations, less current maturities	401	352
	28,661	28,609
Accrued dividends on convertible preferred stock	948	1,146
Commitments and contingencies (see Note 9)		
Stockholders' deficit:		
Preferred stock, \$.01 par value; 5,000,000 shares authorized, 748,772 shares issued and outstanding at December 31, 2009 and March 31, 2010;		
aggregate liquidation preference of \$19,768 at December 31, 2009 and March 31, 2010	7	7
Class A common stock, \$.01 par value; 100,000,000 shares authorized; 48,105,554 shares issued and outstanding at December 31, 2009 and March 31, 2010		
	481	481
Class B convertible common stock, \$.01 par value; 7,500,000 shares authorized;		
1,465,530 shares issued and outstanding at December 31, 2009 and March 31, 2010	15	15
Warrants outstanding; 3,787,880 at December 31, 2009 and March 31, 2010	1,533	1,533
Additional paid-in capital	52,711	52,761
Accumulated deficit	(63,744)	(64,141)
Total stockholders' deficit	(8,997)	(9,344)
Total liabilities and stockholders' deficit	\$ 56,338	\$ 56,491

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

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF OPERATIONS

(unaudited)

(in thousands, except share and per share data)

	Three Months Ended March 31,	
	2009	2010
Net sales	\$ 16,646	\$ 16,391
Cost of goods sold	13,996	13,237
Gross margin	2,650	3,154
Selling and administrative costs	3,204	2,648
Gain from fixed asset disposition	(29)	(1)
Operating income (loss)	(525)	507
Net interest expense	(896)	(706)
Loss before dividends	(1,421)	(199)
Dividends on preferred stock	(208)	(198)
Net loss applicable to common stock	\$ (1,629)	\$ (397)
Loss per share of common stock (basic and diluted)	\$ (0.03)	\$ (0.01)
Weighted average common shares outstanding (basic and diluted)	48,889,210	49,571,084

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

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF CASH FLOWS

(unaudited)
(in thousands)

	Three Months Ended March	
	31,	
	2009	2010
Cash flows from operating activities:		
Net loss applicable to common stock	\$ (1,629)	\$ (397)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,501	1,346
Dividends on preferred stock	208	198
Gain from fixed asset disposition	(29)	(1)
Increase in accounts receivable allowance	-	54
(Increase) decrease in other assets	(56)	59
Changes in current assets and current liabilities	(62)	1,733
Net cash provided by (used in) operating activities	(67)	2,992
Cash flows from investing activities:		
Purchases of land, buildings and equipment	(2,899)	(1,849)
Proceeds from disposition of equipment	29	1
Net cash used in investing activities	(2,870)	(1,848)
Cash flows from financing activities:		
Net payments on line of credit	(500)	-
Payments on notes	(375)	(238)
Payments on capital lease obligations	(52)	(61)
Decrease in cash restricted for payment of debt and construction	2,790	-
Net cash provided by (used in) financing activities	1,863	(299)
Increase (decrease) in cash and cash equivalents	(1,074)	845
Cash and cash equivalents, beginning of period	1,238	243
Cash and cash equivalents, end of period	\$ 164	\$ 1,088

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

NOTES TO FINANCIAL STATEMENTS

Note 1: Unaudited Information

Advanced Environmental Recycling Technologies, Inc. (the Company or AERT) has prepared the financial statements included herein without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). However, all adjustments have been made to the accompanying financial statements which are, in the opinion of the Company's management, of a normal recurring nature and necessary for a fair presentation of the Company's operating results. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented herein not misleading. It is recommended that these financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest annual report on Form 10-K.

Note 2: 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 has been cleaned, sized and reprocessed, and recycled polyethylene plastics which 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 Weyerhaeuser Company (Weyerhaeuser), 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 green (environmentally responsible) 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, and leases warehouses and land for inventory storage. In December 2007, the Company entered into a related party lease for the use of 60 acres in Watts, Oklahoma where it began construction of an additional plastics recycling facility in September 2008. This facility commenced operations in February 2010, and is intended to recycle lower grades of polyethylene plastic scrap in order to reduce the Company's costs of recycled plastics and value added compounds and to allow for potential sales of recycled plastics to third parties.

Note 3: Future Operations

The financial statements of the Company have been prepared on the basis of accounting principles applicable to a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. At March 31, 2010, the Company had a working capital deficit of \$23.5 million and a stockholders' deficit of \$9.3 million. It incurred losses from operations of \$1.1 million and \$19.8 million for the years ended December 31, 2009 and 2008, respectively. The Company has limited additional financial resources available to support its operations and has relied over the last two years on extensions of certain of its financings by its lenders. The Company may require additional financial resources in order to fund maturities of debt and other obligations as they become due. These factors, among others, raise doubt about the ability of the Company to continue as a going concern. The ability of the Company to continue as a going concern is dependent upon the ongoing support of its creditors, investors and customers, and its ability to successfully mass produce and market its products at economically feasible levels. The financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to

continue as a going concern.

The Company plans to resolve its current liquidity issue and structure its operations to grow its business, improve its margins and generate net income for 2010 in order to maximize shareholder value. The Company's immediate liquidity issue is being addressed by:

- 1) Implementing additional cost reductions: A substantial amount of cost has already been eliminated from the Company's operations and additional cost reductions are being identified and implemented.
- 2) Seeking additional sources of revenue: The Company is pursuing additional distribution of its current product line and is introducing new products in order to increase its sales.
- 3) Pursuing additional funding to provide liquidity while restructuring the business: In addition to continuing to seek

potential sources of financing, the Company is pursuing government loan guarantees and investigating grants and low interest loans for companies that produce environmentally responsible green products, as well as seeking alternative less traditional debt and equity financing opportunities.

- 4) Restructuring existing debt to improve short-term liquidity: Both the Company's line of credit and mortgage loan with Liberty Bank were extended through April 15, 2010. The Company is currently working to restructure these debts, which it fully expects to accomplish in the near term. Additionally, the Company has extended its \$6 million bridge loan from Allstate, the holder of the Company's bonds, until December 2011.
- 5) Starting its Watts recycling facility: The Company expects its Watts recycling facility to reduce raw material costs and generate additional sales of recycled materials in 2010.

Note 4: Statements of Cash Flows

In order to determine net cash provided by 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 for the three months ended March 31 (in thousands):

	2009 (unaudited)	2010 (unaudited)
Receivables	\$ (3,321)	\$ 1,840
Inventories	2,242	(1,093)
Prepaid expenses and other	469	385
Accounts payable – trade and related parties	31	950
Accrued liabilities	517	(349)
	\$ (62)	\$ 1,733
Cash paid for interest, net of amounts capitalized of \$270 in 2009 and \$260 in 2010	\$ 274	\$ 215

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

	2009 (unaudited)	2010 (unaudited)
Amortized discount on Allstate note payable	93	

Note 5: Significant Accounting Policies

Revenue Recognition Policy

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 arrangement. Sales are recorded net of discounts, rebates and returns, which were \$0.2 million and \$1.6 million for the quarters ended March 31, 2009 and 2010, respectively. The increase in 2010 was due to the replacement of our discontinued style of handrail with an updated handrail product line.

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 its sales discount rates are fixed and given the predictability with which customers take sales discounts.

Shipping and Handling

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

Inventories

Inventories are stated at the lower of cost or market. The Company's cost is based on standard cost or FIFO (first-in, first-out).

Standard costs approximate actual costs on a first-in, first-out basis. Material, labor, and factory overhead necessary to produce the inventories are included in their cost. Inventories consisted of the following (in thousands):

December 31,
2009

March 31,