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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC

FORM 10-Q
(Quarterly Report)

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SIC Code	2430 - Millwork, Veneer, Plywood, And Structural Wood
Industry	Constr. - Supplies & Fixtures
Sector	Capital Goods
Fiscal Year	12/31

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(X) Quarterly Report Pursuant To Section 13 Or 15(d)

Of The Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 1996
Commission File Number 1-10367

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

DELAWARE	71-0675758
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
206 1/2 East Emma Avenue P.O. Box 1237 Springdale, Arkansas	72765
(Address of Principal Executive Office)	(Zip Code)

Registrant's telephone number, including area code: (501)750-1299

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 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:

As of July 31, 1996, 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 18,198,383 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

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS

ASSETS

	June 30, 1996 (Unaudited)	December 31, 1995
Current assets:		
Cash and cash equivalents	$ 13,444	$ 15,350
Receivables	309,919	48,463
Inventories	498,641	648,211
Prepaid expenses and other	261,085	108,528
Total current assets	1,083,089	820,552
Buildings and equipment, at cost, including construction in progress of $654,811 at 6-30-96, and $22,946 at 12-31-95:		
Buildings	675,420	675,420
Machinery and equipment	8,637,125	7,985,870
Transportation equipment	133,527	112,411
Office equipment	172,598	170,659
Leasehold improvements	315,331	315,331
	9,934,001	9,259,691
Less accumulated depreciation and amortization	3,629,866	3,050,979
Net buildings and equipment	6,304,135	6,208,712
Other assets, at cost less accumulated amortization of $95,367 at 6-30-96, and $83,058 at 12-31-95	331,083	328,478
	$7,718,307	$7,357,742

The accompanying notes to the financial statements should be read in conjunction with these statements.

LIABILITIES AND STOCKHOLDERS' EQUITY

	June 30, 1996 (Unaudited)	December 31, 1995
Current liabilities:		
Current maturities of long-term debt	$ 630,249	$ 755,576
Accounts payable - trade	1,092,439	1,078,243
Payables to related parties	82,364	362,155
Accrued liabilities	216,238	166,779
Notes payable	192,049	14,604
Total current liabilities	2,213,339	2,377,357
Long-term debt, less current maturities -		
Related parties	954,731	1,102,554
Other	154,410	164,088
Total long-term debt	1,109,141	1,266,642
Stockholders' equity		
Preferred stock, $1 par value; 5,000,000 shares authorized, none issued	-	-
Class A common stock, $.01 par value; 50,000,000 shares authorized, 18,198,383 (1996) and 15,692,866 (1995) shares issued and outstanding	181,984	156,929
Class B convertible common stock, $.01 par value; 7,500,000 shares authorized, 1,465,530 shares issued and outstanding 1996 and 1995	14,655	14,655
Additional paid in capital	20,850,557	19,282,865
Deficit accumulated during the development stage	(16,651,369)	(15,740,706)
Total stockholders' equity	4,395,827	3,713,743
	$ 7,718,307	$ 7,357,742

The accompanying notes to the financial statements should be read in conjunction with these statements.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF OPERATIONS (UNAUDITED)

	Three months ended June 30,		Six months ended June 30,	
	1996	1995	1996	1995
Sales	$ 2,057,337	$ 1,395,664	$ 3,659,116	$ 2,566,974
Cost of Goods Sold	1,943,021	1,541,314	3,689,251	2,913,595
Gross Margin	114,316	(145,650)	(30,135)	(346,621)
Selling and Administrative Costs	406,118	351,695	783,489	672,569
Operating Income (Loss)	(291,802)	(497,345)	(813,624)	(1,019,190)
Other Income (Expense)				
Other Income	20,291	760	20,399	784
Interest Expense	(56,699)	(74,569)	(117,438)	(133,534)
Net Loss	$ (328,210)	$ (571,154)	$ (910,663)	$(1,151,940)
Net loss per share of common stock	($.02)	($.04)	($.05)	($.07)
Weighted average number of common shares outstanding	18,225,348	15,503,568	18,225,348	15,503,568

The accompanying notes to the financial statements should be read in conjunction with these statements.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six months ended June 30, 1996	Six months ended June 30, 1995
Cash flows from operating activities:		
Net loss	$ (910,663)	$(1,151,940)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	578,887	493,684
Amortization of other assets	12,309	11,388
Gain on disposition of assets	-	(734)
Increase in other assets	(14,914)	(28,590)
Changes in current assets & current liabilities	(480,579)	7,629
Net cash used in operating activities	(814,960)	(668,563)
Cash flows from investing activities:		
Additions to buildings and equipment	(674,311)	(15,257)
Proceeds of sale of equipment	-	5,000
Net cash used in investing activities	(674,311)	(10,257)
Cash flows from financing activities:		
Proceeds from issuance of notes	269,155	953,822
Payments on notes	(374,538)	(272,281)
Proceeds from issuance of common stock, net	1,592 748	-
Net cash provided by financing activities	1,487,365	681,541
Increase (Decrease) in cash & cash equivalents	(1,906)	2,721
Cash and cash equivalents:		
Beginning of period	15,350	5,977
End of period	$ 13,444	$ 8,698

The accompanying notes to the financial statements should be read in conjunction with these statements.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

NOTES TO FINANCIAL STATEMENTS

Note 1: Unaudited Information

The financial statements included herein have been prepared by Advanced Environmental Recycling Technologies, Inc. (the Company or AERT), 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, 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 generally accepted accounting principles 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: Organization and Description of the Company

Advanced Environmental Recycling Technologies, Inc. (the Company) has developed and commenced the manufacture of a composite building material from waste plastic and wood fiber waste for certain specialized applications in the construction industry. The Company has initially marketed this material as a substitute for wood and plastic filler materials for standard door frames, window sills, and decking. The Company is comprised of two separate, yet interrelated manufacturing facilities located in Junction, Texas and Rogers, Arkansas. The Company's customers primarily consist of a number of regional and national door and window manufacturers and Weyerhaeuser, the Company's primary decking customer.

The Company was initially capitalized on December 2, 1988, with a contribution of machinery and equipment, plant facilities and technology, most of which were used by certain members of management in an unsuccessful prior business. The prior business was organized in June 1985 to manufacture artificial firelogs using certain technology somewhat similar to that used in the Company's manufacturing process. By 1986, the prior business had incurred substantial losses from operations, had no further working capital resources and discontinued its business. The initial contribution consisted of approximately $3,000,000 in buildings, machinery and equipment, supplies and other tangible assets, as well as technological rights and expertise. In connection with such initial organization, the Company assumed $795,000 in bank indebtedness secured by certain of the contributed assets. All amounts are reflected in the accompanying financial statements at the contributor's book value.

Prior to March 31, 1995, the Company was a development stage enterprise whose operations consisted primarily of design development and improvement of the equipment and production process and initial marketing and determination of product markets. Accordingly, the Company has reclassified certain prior period amounts to conform to the current period presentation.

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 June 30, 1996, the Company had a working capital deficit of $1,130,250 and had incurred net losses of $910,663 for the six months ended June 30, 1996. The Company, since inception, has not achieved a successful level of operations nor is there any assurance that the Company will be able to achieve future revenue levels sufficient to support existing operations, generate positive cash flow from operations or recover its investment in its property, plant and equipment. Management believes that the Company's currently available borrowing capacity under its line of credit with a major shareholder is adequate to support its operations until successful production and sales levels are attained, but that it is likely the Company will need additional financing to fund payment of the Company's current maturities of long-term debt due in 1996. The Company has recently restructured its business in order to reduce its plastics division losses and is continuing in its efforts to increase composite sales to a level sufficient to obtain positive cash-flows and overall profitability. However, there can be no assurance that such production and sales levels will actually be reached. The Company is currently negotiating financing to allow for additional composite expansion and working capital which would be in addition to existing support from its major shareholders. The Company has limited additional financial resources available to support its operations and in the past few years has, in large part, been supported by certain major shareholders. There is no commitment for such shareholders to continue such support beyond the current line of credit. The Company also has claims in litigation outstanding against it as described in Note 13, the outcome of which is uncertain. There can be no assurance that the Company's financial resources (which at present are limited to a $433,097 line of credit as described in Note 6) will be adequate to support existing operations until such time, if ever, sales levels are sufficient to generate positive cash flow from operations. Further, if the litigated claims discussed in Note 13 were to be assessed against the Company, the Company would likely be unable to pay such claims. These factors, among others, raise substantial doubt concerning 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 stockholders, investors, customers and creditors and its ability to successfully mass produce and market its product at economically feasible levels.

Effective October 1, 1995, the Company adopted Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, (SFAS 121). SFAS 121 requires an assessment of the recoverability of the Company's investment in long-lived assets to be held and used in operations whenever events or circumstances indicate that their carrying amounts may not be recoverable. Such assessment requires that the future cash-flows associated with the long-lived assets be estimated over their remaining useful lives and an impairment loss recognized when the future cash-flows are less than the carrying value of such assets.

The Company has assessed the recoverability of its investment in long-lived assets to be held and used in operations under the guidelines set forth in SFAS 121 and determined that no impairment loss was required as of June 30, 1996. Such assessment required the Company to make certain estimates of future production volumes and costs and future sales volumes and prices which are expected to occur over the remaining useful lives of its long-lived assets. (Such long-lived assets primarily consist of the Company's Rogers and Junction manufacturing facilities.) The Company's estimates of these factors are based upon management's belief that

future production volumes will significantly increase over previous historical production levels achieved by the Company's manufacturing facilities and that future production costs per unit will also significantly decrease below previous historical cost levels. The Company has restructured its Rogers plastics reclamation facility and believes that no significant production problems will recur at its Junction composite manufacturing facility. As such, management of the Company believes a reasonable basis exists for the use of such future estimates which are significantly better than past historical performance.

Although the Company believes it has a reasonable basis for its estimates of future production volumes and costs and future sales volumes and prices, it is reasonably possible that the Company's actual performance could materially differ from such estimates. Management expects that the Company's performance during the last six months of 1996 will provide additional evidence to confirm or disprove such future estimates. Management also believes that if such estimates are not confirmed, revisions to such estimates could result in a material impairment loss on its long-lived assets constituting all or a material portion of the carrying value of the Company's Rogers and Junction manufacturing facilities which was $6,264,411 at June 30, 1996.

Note 4: Significant Accounting Policies

Statements of Cash Flows

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

	Six months ended June 30, 1996 (unaudited)	Six months ended June 30, 1995 (unaudited)
Receivables	$(261,456)	$ 21,263
Inventories	149,570	(9,892)
Prepaid expenses and other	(152,557)	(95,267)
Accounts payable - trade & related parties	(265,595)	92,044
Accrued liabilities	49,459	(519)
	$(480,579)	$ 7,629

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Buildings and Equipment

Buildings and equipment contributed to the Company in exchange for Class B Common Stock are carried at the contributor's historical book value. Property additions and betterments include capitalized interest, and acquisition, construction and administrative costs allocable to construction projects and property purchases. Gains or losses on sales or other disposition of property are credited or charged to income.

Provision for depreciation and amortization of buildings and equipment is provided on a straight-line basis for buildings and leasehold improvements, transportation equipment and office equipment over the estimated useful lives of these facilities. Machinery and equipment is depreciated on a straight line basis over the estimated useful life of the related equipment or on a units of production basis over the estimated useful production lives of the related assets. Estimated useful lives are; buildings and leasehold improvements 6 to 20 years, transportation equipment - 3 to 5 years, office equipment - 5 years and machinery and equipment - 7 to 12 years or 120 million units (pounds).

Inventories

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

	June 30, 1996 (Unaudited)	December 31, 1995
Raw materials	$166,534	$ 54,279
Finished goods	332,107	593,932
	$498,641	$648,211

Other Assets

Other assets consist primarily of the costs for the preparation of patent applications ($421,361 and $406,447 at June 30, 1996 and December 31, 1995, respectively) which are amortized using the straight-line method over 17 years. Also included in Other Assets are deposits of $5,089.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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.

Recently Issued Accounting Standards

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." This statement encourages entities to adopt the fair value method of accounting for employee stock compensation plans for fiscal years beginning after December 15, 1995, but allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." The Company intends to continue to measure compensation cost for its employee stock compensation plans in accordance with APB Opinion No. 25.

Note 5: Receivables

In April 1993, the Company entered into an agreement with an affiliate whereby the Company agreed to sell certain of its trade receivables which the affiliate deems acceptable. Upon the acceptance of a sale of a receivable, the affiliate will remit to the Company 100% of the receivable, as defined in the agreement, and the Company shall remit to the affiliate .88% as a factoring charge. The Company will indemnify the affiliate for any loss arising out of rejections or returns of any merchandise, or any claims asserted by the Company's customers. During the six months ended June 30, 1996, the Company sold an aggregate of approximately $3,838,025 in receivables under this agreement. Costs of approximately $33,781 associated with the factoring agreement are included in selling and administrative costs for the six month period.

Note 6: Notes payable - related parties

In July 1994, the Company obtained a $1,000,000 line of credit financing agreement with Jim G. and Marjorie S. Brooks. The credit line is secured by substantially all of the assets of the Company and accrues interest at a rate of 8.5% per annum. Proceeds from the line of credit were used to redeem notes payable to related parties and provide working capital for Company operations. At December 31, 1994, the outstanding balance on the line of credit was $1,411,903. In February 1995, the line of credit was increased to $2,000,000 of which approximately $1,566,903 was converted to a term note to be amortized at 9 3/4% over five years beginning April 1, 1995. The balance of $433,097 is a revolving credit line to be available as needed by the Company and as of June 30, 1996, the entire amount was available to the Company.

Note 7: Long-term debt

Long-term debt as of June 30, 1996 and December 31, 1995, consisted of the following:

	June 30, 1996	December 31, 1995
Note payable, due in monthly installments of $10,156 plus interest at prime plus two percent (10.25% at June 30, 1996) through August 1, 1996 and beginning September 1, 1996, monthly installments of $15,354 including interest at 10.75%; secured by certain manufacturing equipment, inventories and receivables.	$ 264,034	$ 324,970
Note payable, due in monthly installments of accrued interest from January 1, 1995 through April 1, 1995, and monthly installments of principal and interest beginning May 1, 1995 with the remaining balance due March 1, 1997, interest at eight percent, secured by unescrowed shares of Class B Common Stock owned by certain officers of the Company and certain manufacturing equipment.	166,025	213,769
Note payable, to a related party, due in 60-monthly installments of principal and interest, beginning April 1, 1995, interest at 9.75%.	1,243,371	1,399,245
Other	65,960	84,234
Total	1,739,390	2,022,218
Less current maturities	630,249	755,576
Long-term debt, net of current maturities	$1,109,141	$1,266,642

The fair value of the Company's outstanding debt is approximately equal to its carrying value at June 30, 1996.

The aggregate maturities of long-term debt as of June 30, 1996 are as follows:

Year	Amount
1997	$ 630,249
1998	456,721
1999	362,463
2000	289,957
2001	0
	$1,739,390

Note 8: Interest

Interest incurred, capitalized, expensed and cash payments for interest are summarized as follows:

	Six months ended June 30, 1996 (unaudited)	Six months ended June 30, 1995 (unaudited)
Interest incurred	$117,438	$133,534
Interest capitalized as part of the cost of machinery and equipment	-	-
Interest expensed	$117,438	$133,534
Cash payments for interest	$131,862	$106,944

Note 9: Stockholders' equity

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.

On November 9, 1989, the Company completed a public offering of 1,250,000 units, at a price to the public of $4.00 per unit. In December 1989, the Company sold an additional 100,000 units to the underwriter at the same price. Each unit consists of three shares of Class A Common Stock and three redeemable Class A Warrants, which are separable and transferable immediately upon issuance. Each Class A Warrant entitles the holder to purchase a unit consisting of one share of Class A Common Stock and one Class B Warrant at an exercise price of $2.00. Each Class B Warrant entitles the holder to purchase one share of Class A Common Stock at an exercise price of $3.00. The Class A and Class B Warrants are redeemable at $.05 per Warrant

at the option of the Company if certain public stock trading prices are achieved and were scheduled to expire in November 1995.

In connection with the public offering, the Class B Stockholders placed in escrow, on a pro rata basis, an aggregate of 5,625,000 shares of Class B Common Stock. The Class B Stockholders continue to vote the escrow shares unless such shares are canceled. Upon the occurrence of certain events, escrow shares were to be released from escrow and returned to the Class B Stockholders if during the calendar year ended December 31, 1994 (1) the Company's minimum pretax income was at least $16 million or (2) the market price of the Company's Class A Common Stock averages in excess of $6.50 per share for 20 consecutive trading days.

The Company did not achieve any of the above requirements, and, as such, the escrowed shares were contributed to the Company's treasury on March 31, 1995 and then canceled.

In March 1992, the Company issued notice of redemption of the aforementioned Class A Warrants, of which approximately 4.3 million were outstanding on the redemption date of April 27, 1992. Prior to the redemption date, holders of 4,212,740 Class A Warrants exercised their warrants at $2.00 per warrant which totalled $8,425,480 in warrant exercise proceeds. Accordingly, the Company issued 4,212,740 shares of Class A Common Stock and 4,212,740 Class B Warrants to the exercisers of the Class A Warrants. The remaining unexercised Class A Warrants were redeemed at $0.05 per warrant. During the fourth quarter of 1992, holders of 300 Class B Warrants exercised their warrants at $3.00 per warrant. In August 1995, the Company's Board of Directors approved a resolution extending the expiration date of the outstanding Class B Warrants to September 1, 1996.

In July 1993, in connection with the increase of $650,000 in Bridge Notes which matured June 29, 1994, the Company issued 650,000 Class C Warrants which are exercisable ratably into one share of Class A Common Stock at an exercise price of $3.00 per share. The Warrants expire on June 29, 1998.

In September 1993, the Company initiated an offering of up to $2,000,000 of discounted gross offering proceeds of Class A Common Stock to qualified foreign investors under Regulation S of the Securities Act of 1933. At December 31, 1993, 736,135 shares of such stock had been issued resulting in approximately $602,000 net offering proceeds to the Company. In January 1994, an additional 450,000 shares were issued, resulting in approximately $344,000 net offering proceeds to the Company. As a part of the offering, the Company has issued 206,751 Class D Warrants to the Stock Placement Distributor. The Class D Warrants expire five years from the date of issue and are exercisable at a price of $1.50 per share of Class A Common Stock for each Class D Warrant exercised.

Also in connection with the Regulation S offering, the Company has reserved for issuance one Class E Warrant for each two shares of Class A Common Stock purchased by the aforementioned qualified foreign investors. The Class E Warrants were issued six months after the Class A Common stockholders' stock acquisition date, provided that the shares of Class A Common Stock were still owned by and registered in the name of the original purchaser as of such date. The Class E Warrant will expire two years from the date of issue and will be exercisable at $1.50 per share of Class A Common Stock for each Class E Warrant exercised. As of June 30, 1996, no Class E Warrants have been exercised and all such Warrants have expired.

In May 1994, the Company completed a Private Placement Offering at market price to certain affiliated stockholders and bridge note holders with the issuance of 3,468,400 shares of Class A Common Stock, 3,468,400 Class F Warrants, and 3,468,400 Class G Warrants. Net offering proceeds of approximately $2,065,000 consisted of $2,020,000 conversion of debt and accrued interest and $45,000 in cash. The Class F and Class G Warrants expire five years from the date of issuance and are exercisable at a price of $.61 and $.92 per share of Class A Common Stock for each Class F or Class G Warrants exercised.

In 1995, in connection with an extension of a line of credit to the Company by a related party (see Note 6), the Company's Board of Directors authorized the issuance of up to 2,000,000 Class H Warrants on a one-for-one basis for each dollar advanced under the loan agreement and having an exercise price equal to the per share market value of the Company's Class A Common Stock on the date of such advances. While no warrants have been issued as of the date of this filing, all authorized Class H Warrants are currently issuable. Upon issue, the warrants will be exercisable at prices from $.39 to $.49 per share of Class A Common Stock for each Class H Warrant exercised. The Class H Warrants will expire in February 2005.

In May 1996, the Company completed a Private Placement Offering with the issuance of 338,624 shares of Class A Common Stock. Net offering proceeds consisted of $200,000 in cash.

In June 1996, the Company completed an offering to qualified foreign investors under Regulation S of the Securities Act of 1933 with the issuance of 1,666,893 shares of Class A Common Stock. Net offering proceeds consisted of $1,146,000 in cash. As a part of the offering, the Company has issued 166,688 Class I Warrants to the Stock Placement Distributor. The Class I Warrants expire three years from the date of issue and are exercisable at prices from $0.9375 to $1.125 per share of Class A Common Stock for each Class I Warrant exercised.

At June 30, 1996, the Company had Class A Common Stock reserved for issuance as follows:

	Class A Common Stock equivalent shares
Class B Warrants	4,212,440
Stock option plans (Note 10)	3,050,000
Class C Warrants	650,000
Class D Warrants	206,751
Class F Warrants	1,337,904
Class G Warrants	3,468,400
Class H Warrants	2,000,000
Class I Warrants	166,688
	15,092,183

Note 10: Stock option plans

The Company's Stock Option Plans (the "1990 Plan" and the "1989 Plan") authorize the issuance of a total of 1,500,000 shares of the Company's Class A Common Stock to its directors, employees, and outside consultants.

The option price of the stock options awarded must be at least equal to the market value of the Class A Common Stock on the date of grant. Stock options may not be granted to an individual to the extent that in any calendar year in which options first become exercisable, the shares subject to options first exercisable in such year have a fair market value on the date of grant in excess of $100,000. Stock options may not be granted after March 2000 and May 1999 for the 1990 Plan and the 1989 Plan, respectively. No option may be outstanding for more than ten years after its grant. The purpose of the Plans is to enable the Company to encourage key employees, directors and outside consultants to contribute to the success of the Company by granting such persons incentive stock options ("ISOs") and/or non-incentive stock options ("nonqualified stock options"). The ISOs are available for employees only.

In order to provide for disinterested administration of the Plans for purposes of Rule 16b-3 under the Securities Exchange Act of 1934, the 1990 Plan also provides that outside directors will automatically receive annual awards of nonqualified stock options.

In June 1994, stockholders of the Company approved the adoption of the Amended and Restated Stock Option Plan which superceded and replaced the Company's 1990 Stock Option Plan. The new Plan provides for the granting of options to purchase up to 1,000,000 shares of the Company's Class A Common Stock by recipients of incentive stock options or non-qualified stock options as granted by the Company's Board of Directors. 406,000 options were granted from this plan during 1995.

The Company's stockholders also approved the Non-Employee Director Stock Option Plan. The Director Plan provides for the issuance of options to purchase up to an aggregate of 500,000 shares of the Company's Class A Common Stock to eligible outside directors of the Company. Each eligible outside director will be granted options to purchase 25,000 shares of common stock annually commencing in 1995 and each year thereafter. In April 1996, 25,000 such options were granted to each of the four outside directors serving on the Board at that time.

Also in June 1994, stockholders of the Company approved the Chairman Stock Option Plan. The Chairman Plan provides that Jim G. Brooks, the Company's Chairman and Chief Executive Officer be awarded a one-time grant, effective May 1, 1994, to purchase 500,000 shares of the Company's Class A Common Stock. The options granted are exercisable at $.63 per share and are vested at the rate of 20% per year commencing on the first anniversary of the grant date.

A summary of the activity in the Company's Stock Option Plans during the six months ended June 30, 1996 is as follows:

	Shares	Per Share
Outstanding December 31, 1995	1,931,668	$.38 - $3.00
Granted	100,000	$.81 -
Forfeited	-	-
Exercised	-	-
Outstanding June 30, 1996	2,031,668	$.38 - $3.00
Exercisable June 30, 1996	1,054,668	$.38 - $3.00

Note 11: Significant customer

During the six months ended June 30, 1996, the Company had $1,333,797 in sales to a single customer which represented 36% of total sales. Additionally, the Company had aggregate sales of $1,445,152 to three other customers which individually represent 22%, 12%, and 5% of total sales. During the six months ended June 30, 1995, the Company had $974,708 in sales to a single customer which represented 38% of total sales.

Note 12: Net loss per share of common stock

The net loss per share of common stock was based on the combined weighted average number of shares of Class A and Class B Common Stock outstanding during the period. For purposes of such calculation, the 5,625,000 shares of Class B Common Stock which were placed in escrow in connection with the public offering were not considered as outstanding after the date of the public offering as the effect of such inclusion would be dilutive to the net loss per share calculation. Further, the Company's other common stock equivalents (options which accompanied the subordinated notes, Class B, C, D, F, G, H and I Warrants issued or contingently issuable, and the stock options) have a dilutive effect on the loss per share calculation and, accordingly, were also excluded.

Note 13: Commitments and contingencies

On June 9, 1992, Mobil Oil Corporation ("Mobil") commenced an action against the Company in the United States District Court for the District of Delaware entitled Mobil Oil Corporation v. Advanced Environmental Recycling Technologies, Inc. In its complaint, Mobil sought entry of a declaratory judgment that: (a)

AERT is without right or authority to threaten suit against Mobil or its customers for alleged infringement of AERT

patents; (b) The AERT patents are invalid and unenforceable, and (c) Mobil has not infringed the AERT patents through any products or method. Mobil seeks no monetary damages in this suit, but does seek reimbursement of its attorneys' fees.

On December 8, 1992, the Company answered Mobil's Complaint. In its Answer, the Company denied Mobil's claims and asserted counterclaims against Mobil and three Mobil executives for: (1) an illegal combination or contract in restraint of trade in violation of federal antitrust laws; (2) a pattern of intentional misconduct constituting an attempt to monopolize in violation of federal antitrust laws; (3) breach of a confidential relationship between Mobil and the Company; and (4) unfair competition. The Company sought monetary damages, punitive damages and injunctive relief. Mobil filed an answer to AERT's counterclaims, denying any liability. The Delaware Court then bifurcated the trial into patent and non-patent issues and ordered the patent issues tried first.

In February 1994, after a trial on the patent issues, a Delaware jury returned a verdict that four AERT patents on its composite product technology were invalid. The jury also determined that Mobil had not infringed two of the four patents which AERT had asserted against Mobil. The jury verdict answered a number of interrogatories on the factual issues, and rendered advisory findings for the Court on Mobil's allegation that AERT had obtained its patents by inequitable conduct. Thereafter, the Judge adopted the jury's advisory findings on inequitable conduct and held that each of the four AERT patents were unenforceable for failure to disclose certain alleged prior art to the patent office during patent prosecution.

Because of the nature of certain of the jury verdict interrogatory responses, AERT's counsel concluded that the verdict was adversely affected by improper conduct by Mobil counsel during trial, and false statements of law and fact made during closing argument, that caused the jury to misapply the law on inequitable conduct and to render clearly erroneous findings. Consequently, AERT moved for a new trial. That motion was denied. The Company's additional post-trial motions were also denied by the Delaware Court. On March 14, 1995, the Company filed a sealed motion with the Court based upon newly discovered evidence which alleges prejudicial misconduct by Mobil prior to the trial. The motion also brings to the Court's attention,evidence which the Company believes was intentionally withheld from it in direct defiance of the Delaware Court's January 4, 1994 Motion to Compel, prior to the trial. It also brings to the Court's attention, an official government safety approval document which was altered prior to submission to AERT during pre-trial discovery, which also relates to a portion of the alleged withheld discovery documentation. The motion seeks further discovery into Mobil's misconduct, and a new trial. In December 1995, the Company also moved to supplement its pending March 14, 1995 Motion with additional tampered evidence and discovery misconduct by Mobil. Although the March 14, 1995 Motion is still pending before the Delaware Court, the Company filed an appeal with the U.S. Court of Appeals on July 10, 1995 on the initial trial arguments. In January 1996, oral arguments were presented before the U.S. Court of Appeals. On June 13, 1996, the U.S. Court of Appeals issued a decision which vacated the judgment of invalidity against two AERT patents and upheld and affirmed the invalidity of two AERT patents. The Company is currently evaluating its legal options, and has until September 13, 1996 to further appeal the decision to the U.S. Supreme Court. Should the Delaware Court deny the Company's pending Prejudicial Misconduct Motion, the Company intends to follow-up with an additional appeal on these issues. Should the Court not rule in favor of the Company on such motions, all appellate processes available will be pursued. There can be no assurance that the Company will receive a more favorable outcome upon appeal.

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The Company's counterclaims against Mobil and other defendants are to be heard in a separate trial which has not yet been scheduled.

ARTHUR ANDERSEN LLP

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

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

We have reviewed the accompanying balance sheet of Advanced Environmental Recycling Technologies, Inc. (a Delaware corporation), as of June 30, 1996, and the related statements of operations for the three-month and six-month periods ended June 30, 1996 and 1995, and the statements of cash flows for the six-month periods ended June 30, 1996 and 1995. These financial statements are the responsibility of the company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with generally accepted accounting principals.

/s/ ARTHUR ANDERSEN LLP

Arthur Andersen LLP

San Antonio, Texas
August 7, 1996

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

During the second quarter of 1995, the Company substantially completed development of its commercial manufacturing processes and further defined the principal markets for certain of the Company's products. The Company, therefore, exited the development stage and has reclassified certain prior period amounts to conform to current period reporting presentation. While the Company will continue to expend amounts related to the research and development of new products, such amounts are not expected to be material in relation to prior periods. The Company's efforts are now primarily directed towards increasing production capacity and efficiency and profitability, expanding its customer base, and promptly attaining positive cash-flows.

In May 1995, the Company entered into an exclusive marketing and distribution agreement with a division of Weyerhaeuser, Inc. ("Weyerhaeuser") for sales of its Lifecycle(TM) line of extruded decking components, which are primarily targeted towards the high-end residential housing market. Weyerhaeuser will market the product under the Company's trade-name, ChoiceDek(TM), initially in a limited number of its 80 distribution and reload centers throughout the United States and Canada. To date, the Company has experienced a substantial backlog for its residential decking products with Weyerhaeuser Distribution and has recently commenced a production expansion program intended to increase production capacity for Weyerhaeuser and its other customers.

As a result of the Weyerhaeuser agreement, the Company's sales efforts are now primarily focused towards the following three market areas which are supplied by the Company's composites manufacturing facility in Junction, Texas (the "Junction Facility"): (1) components for the national door and window market,
(2) the heavy industrial flooring market as floor blocks for industrial applications, and (3) as decking components for commercial and residential applications through Weyerhaeuser. The Company will continue to primarily utilize production capacity of its plastics reclamation facility in Rogers, Arkansas (the "Rogers Facility") as a source of raw materials supply for the Junction Facility. The Company has increased the production capacity of its composites manufacturing operation, during the second quarter, to levels that will require substantially all of the Rogers Facility's production to be dedicated thereto. However, as additional product demand warrants, the Rogers Facility can increase production by extending such facility's operating hours or by adding additional equipment.

The Company currently maintains a concentrated customer base with approximately 70% of its sales directed to three customers. (See Note 11 to Financial Statements.) The Company is currently unable to predict the future size of the markets for its composite building products, however, the Company believes that the national door and window and residential decking material markets are significant. The Company believes that it can further penetrate these markets and/or expand sales to its existing customer base if the Company's goals for increased production capacity and efficiency are achieved. By focusing its marketing strategy on a limited number of large door and window companies, and by initiating sales of its new decking products through the Weyerhaeuser marketing and distribution agreement, the Company believes it can increase market penetration and sales without significantly increasing administrative overhead. To a lesser extent, the Company's marketing focus also utilizes outside commissioned sales representatives for a portion of its door and window accounts.

Results of Operations

Quarter ended June 30, 1996 compared to quarter ended June 30, 1995

Net sales of $2,057,337 for the quarter ended June 30, 1996 represented an increase in sales of 47% or $661,673 over the second quarter of 1995. Sales by the composite products division increased from $997,965 in the second quarter of 1995 to $2,057,337 in the second quarter of 1996; an increase of 106%. This increase was due to increased production focus on composites in conjunction with partial start-up of a third extrusion line and increased product demand from a larger customer base. The Company phased out of plastic sales to third parties and completed re-deploying assets of the Rogers plastic division during the second quarter. As part of that restructuring, certain plastics equipment, no longer required, was traded for equipment required for a third composite line at Junction, Texas and equipment for a second plastics reclamation line at the Rogers facility. The plastics division focused on producing for composites and set a production record during the second quarter of 1996.

Cost of goods sold was $1,943,021 for the second quarter of 1996 compared to $1,541,314 for the second quarter of 1995. The overall cost of goods sold to sales ratio showed improvement over 1995 and posted a positive gross margin of $114,316 for the second quarter of 1996 vs. a negative $145,650 for the second quarter of 1995. The increase in cost of goods sold was primarily attributable to increased raw material, labor costs, and start-up of the third extrusion line. Significant categories are as follows:

Expense Category	1996	1995
Payroll and payroll taxes	$ 873,030	$ 491,782
Depreciation	296,410	221,303
Direct material costs	183,770	401,381
Other	589,811	426,848
Total	$1,943,021	$1,541,314

Selling, general and administrative expenses were $406,118 vs. $351,695 during the second quarter of 1995. The net loss for the quarter ended June 30, 1996 was $328,210, or a net loss per weighted average common share outstanding of $.02. The loss compares to a loss of $571,154, or a net loss per weighted average common share outstanding of $.04 for the three months ended June 30, 1995. The loss was attributable to costs associated with less than desired operating efficiencies in conjunction with increased labor and marketing costs. The Company commenced limited operation of a third extrusion line and ramped it up to full production late in the second quarter, while also cross-training additional employees for the start-up of a fourth extrusion line which is scheduled for the third quarter of 1996. The composites division has experienced unanticipated manufacturing difficulties over the last two quarters which resulted in poor operating efficiencies and higher costs. As previously disclosed, local and state law enforcement agencies are currently investigating whether these problems are intentional. The Company has recently added additional cleaning equipment and security equipment, including video surveillance cameras throughout the composite manufacturing facility in an attempt to prevent and stop these problems which appear to be of an ongoing nature. Management intends to continue to take such action as it deems necessary to resolve and eliminate these manufacturing problems.

The Company's limited production capacity and output had resulted in a significant order backlog. To address the Company's current production backlog, in addition to taking the various above described measures, the Company has increased its manufacturing capacity through the addition of a third production line at the Junction, Texas composites manufacturing unit and has started construction of a fourth line which is scheduled for completion by September 1996. The increased production of the Company's composite products and accordingly, the composites division's increased raw-material requirements has prompted the Company, in the first quarter of 1996, to discontinue reclamation of plastics for sale to third-parties and dedicate all of the plastic facility's production to providing materials to the Junction operation. In connection with this restructuring of the plastics reclamation plant, the Company exchanged certain equipment, previously utilized to produce plastics for sale to third-parties, for other equipment which will be utilized in a second plastics reclamation line to produce raw-materials and which was used in the installation of the third production line at the Company's composite facility. The Company has also entered into a letter of intent with an Arkansas based manufacturing company to establish a new composites manufacturing facility in northern Arkansas. An entity has been established as Sutton Engineered Wood Products, and the Company anticipates contributing certain manufacturing assets for a minority interest in the Company. The Company intends to license its technologies to the new entity and it is anticipated that said entity will manufacture composites materials under an exclusive contract with the Company. The target date for start-up of the first phase of the new facility is the first quarter of 1997.

The Company believes that the additional production lines at Junction and Rogers, as well as the construction of the new composites facility should allow the Company to reduce its existing backlog, thereby significantly increasing sales and service to its existing customer base and to improve existing operating efficiencies as a result of increased economies of scale. However, the Company's operations remain subject to numerous risks associated with the continued establishment of its business, including lack of financing sources and competition from numerous large, well-established and well-capitalized competitors who manufacture products for the same applications. In addition, the Company has in the past and may again in the future, encounter unanticipated problems, including manufacturing, distribution, and marketing difficulties, some of which may be beyond the Company's financial and technical abilities to resolve. The occurrence of, or failure to adequately address such difficulties could have a material adverse effect on the Company's prospects, including its ability to achieve anticipated sales levels, positive cash-flows from operations and profitability.

Six-months ended June 30, 1996 compared to six-months ended June 30, 1995

Cost of goods sold was $3,689,251 for the six-months ended June 30, 1996 compared to $2,913,595 for the first half of 1995. The overall cost of goods sold to sales ratio showed a significant improvement over 1995. The increase in cost of goods sold was primarily attributable to increased raw material, labor costs, and start-up of the third extrusion line. Significant categories are as follows:

Expense Category	1996	1995
Payroll and payroll taxes	$1,495,562	$1,028,176
Depreciation	569,929	466,012
Direct material costs	491,915	535,075
Other	1,131,845	884,332
Total	$3,689,251	$2,913,595

Liquidity and Capital Resources

At June 30, 1996, the Company had a working capital deficit of $1,130,250 compared to a working capital deficit of $1,566,805 at December 31, 1995. The decreased deficit is primarily attributable to the Company's 1996 operating loss and a decrease in current maturities of long-term debt. Cash and cash equivalents decreased in the first half of 1996. Significant components of that decrease were: (i) cash used in operating activities of $814,960, which consisted of the net loss for the period of $910,663, reduced by depreciation and amortization of $591,196, and other uses of cash of $495,493; (ii) cash used in investing activities of $674,311, and (iii) cash provided by financing activities of $1,487,365. Payments on notes during the period were $374,538 and proceeds from the issuances of notes amounted to $269,155. At June 30, 1996, the Company had notes payable in the amount of $1,931,439, of which $822,298 were current notes payable or current portion of long-term debt. In January 1996, a major stockholder, Marjorie S. Brooks (the "Major Stockholder"), exercised 500,000 Class F Warrants. The proceeds from the exercise of these warrants, which amounted to $305,000, reduced the working capital deficit of the Company and were used to reduce current liabilities.

The Company maintains an accounts receivable factoring agreement for up to $650,000 through an affiliated company of a related party. The terms of this agreement call for the factor to advance 99.12% of the total of invoices presented by the Company and for the Company to indemnify the factor against loss of the amounts advanced. At June 30, 1996, approximately $66,000 was available to factor additional receivables. The Company also maintains a line of credit from the Major Stockholder which consists of a long-term note payable, which had a balance of $1,243,371 at June 30, 1996, and a $433,097 revolving line of credit to be available as needed. As of June 30, 1996, the total amount of the line was available.

Since the completion of the first quarter, the Company has received additional sources of capital as described below, which have been primarily used to add additional manufacturing capacity for composite production. Historically, revenues have not been sufficient to support the Company's current operational needs. However, the Company continues to attempt to improve production rates and efficiencies in an effort to reduce or

eliminate the need for additional future capital to support existing operations. Further, continued improvements in production efficiency and capacity will be required for the Company to increase sales to a level that will allow the Company to attain profitability. There can be no assurance that such improvements in production efficiency or capacity will be achieved.

As previously disclosed, Management is currently undertaking steps to increase sales to its existing customer base by expanding its production capacity. The Company has recently added a third production line at its Composites Manufacturing Facility and intends to add a fourth production line by the end of June 1996. The Company expended approximately $788,416 during the second quarter for a third and fourth extrusion line and for additional building and site work at the Junction plant. To finance existing operations and the required capital expenditures, the following transactions were completed during or subsequent to the first quarter: (i) the Company traded assets for additional equipment which was deployed as part of the third production line; (ii) the Company received $305,000 from Warrant Conversions from the Major Stockholder as described above; (iii) the Company sold an aggregate of 1,666,893 shares of Class A Common Stock to accredited overseas investors in a transactions exempt under Regulation S of the Securities Act of 1933 for an aggregate purchase price of $1,146,000 and (iv) the Company sold 338,624 shares to an existing non- affiliated AERT shareholder for a purchase price of $200,000. The Company also restructured and refinanced an existing Note with the Dow Credit Corporation. In addition to the foregoing, the Company has currently outstanding, approximately 4.2 million Class B Warrants with an exercise price of $3.00. The expiration date of the Class B Warrants is September 1, 1996. The Company also has outstanding 1,530,663 Private Placement Warrants held by non-affiliated entities, which, if exercised by holders, could generate equity capital for the Company (See Note 9 to the Financial Statements). The receipt of additional funds by the Company upon exercise of any such warrants, however, is subject to a number of contingencies, including, but not limited to, (i) compliance with applicable federal and state securities laws, (ii) the desire and ability of the holders to exercise their warrants, and (iii) the market price of the Company's stock.

There can be no assurance that the Company will be able to maintain its current operating levels or achieve increased production volumes and sales levels or that the Company could obtain additional capital resources to support manufacturing operations if required.

If the Company is unable to achieve and maintain a successful level of operations in the near future or unable to secure additional debt or equity financing to provide support to ongoing operations, or were it to be assessed the Mobil legal claims described in Note 13 to the financial statements, it is likely the Company will be unable to continue as a going concern.

PART II. Other Information

Item 1. Legal Proceedings

On June 9, 1992, Mobil Oil Corporation ("Mobil") commenced an action against the Company in the United States District Court for the District of Delaware entitled Mobil Oil Corporation v. Advanced Environmental Recycling Technologies, Inc. In its complaint, Mobil sought entry of a declaratory judgment that: (a)

AERT is without right or authority to threaten suit against Mobil or its customers for alleged infringement of AERT

patents; (b) The AERT patents are invalid and unenforceable, and (c) Mobil has not infringed the AERT patents through any products or method. Mobil seeks no monetary damages in this suit, but does seek reimbursement of its attorneys' fees.

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SIGNATURES

Pursuant to the requirements 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/ David C. Chapman

David C. Chapman, Chief Financial Officer

DATE: August 14, 1996

ARTICLE 5

PERIOD TYPE	6 MOS
FISCAL YEAR END	DEC 31 1996
PERIOD START	JAN 01 1996
PERIOD END	JUN 30 1996
CASH	13,444
SECURITIES	0
RECEIVABLES	309,919
ALLOWANCES	0
INVENTORY	498,641
CURRENT ASSETS	1,083,089
PP&E	9,934,001
DEPRECIATION	3,629,866
TOTAL ASSETS	7,718,307
CURRENT LIABILITIES	2,213,339
BONDS	0
PREFERRED MANDATORY	196,639
PREFERRED	0
COMMON	0
OTHER SE	4,199,188
TOTAL LIABILITY AND EQUITY	7,718,307
SALES	3,659,116
TOTAL REVENUES	3,659,116
CGS	3,689,251
TOTAL COSTS	4,472,740
OTHER EXPENSES	(20,399)
LOSS PROVISION	0
INTEREST EXPENSE	117,438
INCOME PRETAX	(910,663)
INCOME TAX	0
INCOME CONTINUING	(910,663)
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	(910,633)
EPS PRIMARY	(.05)
EPS DILUTED	(.05)

End of Filing

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