

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC

FORM 10-K405

(Annual Report (Regulation S-K, item 405))

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Address	914 N. JEFFERSON STREET
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	SPRINGDALE, AR 72764
Telephone	479-756-7400
CIK	0000849706
Symbol	AERT
SIC Code	2430 - Millwork, Veneer, Plywood, And Structural Wood
Industry	Constr. - Supplies & Fixtures
Sector	Capital Goods
Fiscal Year	12/31

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the Year Ended December 31, 1995

Commission File Number 1-10367

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

DELAWARE
(State or other jurisdiction of
incorporation or organization)

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

901 W. ROBINSON
P.O. BOX 1237
SPRINGDALE, ARKANSAS
(Address of Principal Executive Office)

72765
(Zip Code)

Registrant's telephone number, including Area Code: (501)750-1299

Securities Registered Pursuant to Section 12(b) of the Act:

Class A Common Stock, \$.01 par value

Redeemable Class B Warrants

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: NO:

INDICATE BY CHECK MARK IF DISCLOSURE OF DELINQUENT FILERS PURSUANT TO ITEM 405 OF REGULATION S-K 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. YES: NO:

Aggregate market value of voting stock held by non-affiliates of the registrant at March 5, 1996: \$10,149,194

Number of shares of the common stock outstanding at March 5, 1996:

Class A - 16,192,866

Class B - 1,465,530

PART I

ITEM 1. BUSINESS

GENERAL

Advanced Environmental Recycling Technologies, Inc., ("AERT" or the "Company") is comprised of two separate, yet interrelated manufacturing facilities; the Composites Manufacturing Unit located in Junction, Texas, which manufactures and markets moisture resistant composite building materials made from waste plastics and by-product wood fibers, and the Plastics Reclamation Unit located in Rogers, Arkansas, which processes waste plastics, forming various materials that are used in the composite manufacturing process. The Company markets its moisture-resistant and dimensionally stable composite building materials under the trade names Moistureshield(TM), Lifecycle(TM), and CHOICEDEK(TM). The Company markets its products into three areas; 1) the door and window component market, 2) the heavy industrial flooring market, and 3) the high-end residential and commercial decking market. AERT was founded in December of 1988 and since inception, has completed research and development resulting in the receipt of twelve U.S. Patents on its technologies and systems. (See Item 3. "Legal Proceedings".)

The Company employs a three-part business strategy: (1) it utilizes low-cost waste products and internally-produced products as raw materials; (2) it configures its production facilities so that it can economically manufacture a broad range of products on the same equipment in short production runs and (3) its marketing program identifies and sells to niche markets with defined needs in which the Company believes it can be prominent or dominant.

THE COMPOSITES UNIT

The Company's Composites Manufacturing Unit located in Junction, Texas markets its moisture-resistant composite building materials under the trade names MOISTURESHIELD(TM), LIFECYCLE(TM), and CHOICEDEK(TM). The composite materials are hard, dense, short-grained substances with a dark, speckled surface appearance. Because of their plastic content, the composites can be engineered for moisture resistance, do not require preservative or chemical treatments like traditional wood, can be designed and extruded to customer specifications to minimize waste, and are less subject to rotting, cracking, warping, insect infestation and water absorption than conventional wood materials. Because of the wood fiber content, composites are less subject to thermal contraction or expansion and display greater dimensional stability than conventional plastic materials for such applications. The composites are denser than the straight-grained, clear grades of wood from western United States forests traditionally used in the building applications for which AERT's products compete.

The composites manufacturing process involves proprietary technologies and specialized manufacturing equipment, custom-built or modified for the Company's purposes. It utilizes recycled plastics and wood-filler materials and, in certain cases, special additives or virgin plastics in varying mixtures which can be formulated based on the customer's desired end-product characteristics. A key advantage of the Company's process is the ability to utilize plentiful, low-cost raw material components, encapsulate the wood fibers in the plastic and

create a consistent material, free of foreign matter, which can be extruded into a desired shape while the end product maintains many properties similar to traditional wood materials.

The Composite Manufacturing Unit is comprised of a cedar fiber raw material processing department, a composite extrusion department, a millwork and fabrication department, and a priming and paint department. The raw materials processing department consists of cedar fiber cleaning, drying, grinding and storage equipment; the extrusion department consists of two extrusion and downstream production lines; the millwork department consists of two molding and end-work lines; and the painting department consists of inspection, preparation and a painting and drying line.

Due to increased composite sales demands, the Company is expanding its composite manufacturing facility by adding a third extrusion line, and is also evaluating establishing additional composite manufacturing capability. In the first quarter of 1996, the Company discontinued plastics sales to third parties and intends to utilize all plastics produced by its plastics division internally for composite production.

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.

THE PLASTICS RECLAMATION UNIT

The Plastics Reclamation Unit located in Rogers, Arkansas was established to develop plastic recycling technology primarily to serve as a dependable, cost-effective source of plastic raw material for the Composites Manufacturing Unit. The Company began activities at its Plastics Reclamation Unit in 1990. Since that time, the Company has further developed its patented and proprietary waste plastics reclamation technologies which allow it to recover waste plastics from the by-product of paper recycling mills, as well as certain waste plastic from post-consumer or industrial plastic films. See " - Supply and Pricing of Raw Materials". Secondary fiber recovery mills recycle paper and polyethylene-coated paperboard to recover the paper fiber through a process known as hydropulping. The by-product of the hydropulping process is a water-saturated mixture of polyethylene and unrecovered paper fiber, which most such mills currently dispose of without further processing. Using certain plastics recycling technologies, which such paper recycling companies do not generally have available, the Company has been able to economically recover polyethylene suitable for use in its composite manufacturing process.

In 1991, while continuing to develop its initial plastic recycling technology, the Company entered into a technology development agreement with The Dow Chemical Company for the purpose of further developing and commercializing the Company's plastic reclamation technology for additional applications of polyethylene films. The Company received an initial 10 million pound market development order from Dow in 1992 for recycled plastic. However, that order was restructured in 1994, allowing the Company to significantly reduce indebtedness. Pursuant to the restructuring, Dow forgave approximately \$879,000 in debt from the Company in lieu of purchasing the remaining portion of the recycled plastic. Following the restructuring and completion of the Dow contract, the Company began utilizing production capacity not required for processing raw materials

for the Composites Manufacturing Unit to produce other types of materials for sale to manufacturers of grocery bags, trash bags, and other manufacturers of plastic goods desiring recycled content in their products.

Through 1995, the Company's plastics reclamation facility was involved in sales of recycled plastics to third-party film manufacturers. The materials desired by these customers required substantial processing beyond that necessary to produce raw-materials for the composites facility and were never efficiently produced. This, coupled with increased sales 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 to produce raw-materials and for additional equipment necessary to complete the installation of a third production line at the Company's composite facility.

SUPPLY AND PRICING OF RAW MATERIALS

The Company's composites are currently manufactured from cedar fiber, polyethylene industrial and post-consumer film scrap and ground industrial and post-consumer high-density polyethylene containers. AERT has no formal supply agreements for the cedar fiber or waste plastics used in its composite manufacturing process, although it is the Company's intention to enter into such supply agreements in the future. The Company currently purchases raw materials from sources which it believes are dependable and adequate for at least its short-term manufacturing requirements, and the Company believes suitable alternative sources are available. However, a significant disruption of supply arrangements or significant increases in raw material prices could have a material adverse effect on AERT's operations.

Cedar Fiber. The composite facility is located near four cedar mills which extract cedar oil for perfumes and industrial detergents and dispose of the cedar fiber as a by-product of their operations. The Company, in the past, has purchased all of the wood fiber required for its manufacturing purposes from these mills. Although the Company believes it has access to sufficient supplies of cedar fiber for the foreseeable future, the Company has also manufactured its composite material with other types of wood fibers, and believes that a number of substitute wood fibers could be satisfactorily used in its manufacturing process and that other sources are currently available.

Recycled Plastics. The cost of recycled waste plastics for use in the composites manufacturing process has been subject to significant market fluctuations over the past several years and the Company has experienced supply problems associated with contaminated plastics in the past. Accordingly, to reduce its exposure to such price volatility and potential supply disruptions, the Company in 1990 developed its own patented plastic recycling technologies and established the waste Plastics Reclamation Unit in Rogers, Arkansas to assure itself of a cleaner, more dependable and consistent supply of plastic raw material for its composite manufacturing operations.

The Company's plastics manufacturing processes primarily focus on recycling the following polyethylene films for use in the composites manufacturing process:

- Low Density Polyethylene ("LDPE") poly coatings or linings from recycled bleached food-board, which are generated from the hydropulping process;
- High Density Polyethylene ("HDPE") and Low Linear Density Polyethylene ("LLDPE") mixed plastic grocery bags from supermarket and store collection programs; and
- HDPE ground container material.

These films are highly contaminated with paper and other non-plastic materials which makes them less desirable for traditional plastic uses, and thus lessens their value to producers of recycled plastics. However, plastic used for the Company's Composites Manufacturing Unit does not require the purity, extensive cleaning, additional washing and melt filtration associated with conventional plastics, and can be processed faster and more economically. Further, these contaminated plastics are acquired by the Company at minimal costs (i.e. primarily freight costs). By focusing on contaminated plastics, the Company is able to process these materials through its Plastics Reclamation Unit and produce an acceptable lower-cost feed stock for the composites facility. The Company believes that it has adequate and reliable sources of LDPE hydropulp and HDPE/LLDPE mixed plastic grocery bags for the foreseeable future. The Company also from time to time purchases plastic, if available at reasonable costs and quality, from outside sources, such as brokers or other plastic recyclers, to supplement the above described sources.

The Company has negotiated an informal supply agreement with one national company which operates a fiber recovery mill. The Company takes the plastic by-products generated by this mill for minimal freight thereby reducing the supplier disposal costs. The Company has identified numerous sources of this material. The Company's goal is to reprocess this LDPE plastic for around .20c per pound, which compares with a current virgin price of LDPE coating material of approximately .35c per pound.

MARKETING AND SALES

The Company has directed its initial marketing activities to specialized market segments in the building and construction industry in which cost and physical characteristics place AERT's composite products, such as the subsurface component pieces of standard door and window products, at a competitive advantage over alternative conventional materials and in which the current weaknesses of composites (for example, certain of its strength and aesthetic characteristics) are not critical disadvantages.

To the extent a prospective customer currently uses wood for such component pieces, the Company emphasizes the "value-added" potential of its MOISTURESHIELD composite product which, unlike competing wood products, can be engineered to incorporate certain desired end-product characteristics. The Company also calls the prospective customer's attention to the savings in time and expense that can be achieved by designing into the equipment used in the extrusion process much of the millwork required in the customer's finished product.

In addition, the Company emphasizes the customer's avoidance of the chemical treatments and in plant volatile organic compounds requirements often necessary to give competing wood products durability and the customer's avoidance of the substantial scrap wood or sawdust waste-product typically generated in the sawing and milling process.

MOISTURESHIELD composites have been previously marketed primarily to companies that manufacture products for use by the construction industry in new home construction and home improvement work. The construction industry is subject to significant fluctuations in activity and periodic downturns caused by general economic conditions. Reductions in construction activity could have an adverse effect on the demand for AERT composites; however, the Company believes that its market diversification program will reduce the effects that fluctuations in construction activity would have on the Company. The Company also focuses heavily on products for the home improvement market, which often tends to increase in activity when housing starts decline, and the Company further expanded its marketing focus with its LIFECYCLE products to accommodate a wider range of applications in order to avoid being totally dependent on one industry.

In May 1995, the Company entered into an exclusive marketing and distribution agreement with a division of 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.

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 Unit: (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 currently maintains a concentrated customer base. The Company is 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.

INDUSTRY STANDARDS

ASTM and certain industry trade organizations have established general standards and methods for measuring the characteristics of specific building materials. Users of building materials (and frequently, issuers of building codes) generally specify that the building materials comply with such standards relative to the proposed applications. Since no standards or methods have yet been established for measuring the characteristics of

wood-plastic composite building materials, such as the Company's composites, users cannot judge whether or not it may be suitable for their particular requirements without conducting their own testing. The lack of such accepted standards (and the assurance of extensive testing, quality control and performance capability which compliance with accepted standards typically provide) may limit the market potential of the Company's building materials and make potential purchasers of such building materials reluctant to use them.

The Company has accumulated significant product test data and begun the internal preparation of proposed guidelines for wood-plastic composite materials for certain construction applications for eventual submission to ASTM committees. The consideration and testing of proposed standards by ASTM is a lengthy process, however, typically requiring several years at a minimum. Although the Company believes that its proposed submission will expedite serious industry-wide consideration of such standards, there can be no assurance that industry-accepted standards will be adopted by ASTM, or, if adopted, that ASTM-promulgated standards would be compatible with the technological and product capabilities of the Company.

COMPETITION

In seeking to introduce MOISTURESHIELD composites as alternative building materials to high grade western pine and other woods, aluminum, high-performance plastics and other construction materials, the Company competes with major forestry product companies, aluminum fabricating companies, and major plastic and petrochemical companies. The conventional material manufacturers with which the Company must compete have, in many cases, long-established ties to the building and construction industry and have proven, well-accepted products.

Many large competitors also have research and development budgets, marketing staffs and financial and other resources which far surpass the resources of the Company. There can be no assurance that such competitors will not attempt to develop and introduce similar recycled composite materials. The Company must also compete in the building materials market with certain other plastics recyclers currently manufacturing recycled materials intended for similar building material applications, including decking and fencing. None of such recyclers, to the Company's knowledge, have achieved significant commercial acceptance to date, however, Mobil Oil Company has recently entered the market with a new composite products division and a decking and fencing product called Timbrex, which was recently renamed Trex. Mobil has many resources, has initiated a large national marketing and advertising program and is a significant competitor in recycled plastic products. Mobil has challenged and invalidated four AERT composite patents, and is continuing to assert a claim for substantial attorney's fees against the Company. See Item 3. "Legal Proceedings". If a final determination in this matter is unfavorable to the Company, it can be expected that the Company will be faced with additional competition with respect to certain products.

As the Company has developed its own plastics reclamation technologies, it has in certain instances been required to compete for raw materials with other plastics recyclers, or plastic resin producers, most of which are far larger and better established than the Company. However, management believes that its focus towards sources of contaminated polyethylene films that it recycles and uses in its composites business are less attractive to most producers of recycled plastics. As a result, the Company has not historically experienced significant competition for such raw materials. Further, the Company believes that the plastics reclamation processes it has developed for composite manufacturing business are targeted to the waste management needs of particular

industrial waste generators, to plastic film wastes and to other plastic waste generators, whose potential as a recycling source is not being utilized to a significant extent by current plastics recyclers, rather than to post-consumer, source-separated plastic containers recycling processes, in which a substantially greater number of plastics recyclers compete for plastic waste materials. The Company may encounter new entrants into the composites or plastics reclamation business which could effect the Company's source of raw materials supply and who may have substantially greater financial and other resources than the Company and which may include beverage bottlers, distributors and retailers as well as forestry product producers, petrochemical and other companies. For example, Mobil is now competing with the Company for certain raw materials in connection with the production of its Trex product described above.

PATENTED AND PROPRIETARY TECHNOLOGY

The Company's composite manufacturing process and its development efforts in connection with waste plastics reclamation technologies involve patents and many trade secrets which are considered proprietary by the Company, as well as certain methods, processes and equipment designs for which the Company has sought additional patent protection. The Company has taken measures which are designed to safeguard its trade secrets by, among other things, entering into confidentiality and nondisclosure agreements. Should the Company's trade secrets be disclosed notwithstanding these efforts, the business and prospects of the Company could be materially and adversely affected. The Company has filed seventeen patent applications and have received issuance from the United States Patent and Trademark Office for twelve patents, five of which relate to the Company's composite materials manufacturing operations and seven of which relate to its waste plastics reclamation technologies. The patent applications recently allowed relate to the Company's extrusion process, extrusion apparatus, and its continuous downstream cooling and forming conveyor system, and its plastic reclamation process and equipment. In February 1994, in litigation with Mobil Oil Corporation, a Delaware jury returned a verdict that four AERT patents on its composite product technology were invalid. See Item 3. "Legal Proceedings". The Company's additional pending applications relate to additional manufacturing apparatus, the composite product composition and technology involving its film reclamation processes. There can be no assurance such additional patents will be allowed. The Company has granted Dow Chemical a nonexclusive worldwide license with respect to its waste plastics reclamation technology and will accordingly seek appropriate international patent protection on such technology as well. The Company intends to take other steps reasonably necessary in the future to protect its existing technology and any technology which may be subsequently developed. The Company may license its technologies to industrial users in the future if licensing terms can be agreed upon and if the Company believes it can preserve adequate demand for its own products.

EMPLOYEES

At December 31, 1995, the Company employed 125 full-time personnel, 12 of whom are executive or office personnel and 113 of whom are full-time factory personnel. The Company, from time-to-time, employs additional persons on a part-time basis in its manufacturing operations. The Company anticipates that as its business expands it will employ additional management personnel and factory personnel.

ITEM 2. PROPERTY

The Company conducts its composite products manufacturing operations from a 33,000 square foot facility on a seven-acre site in Junction, Texas. The grounds and a 10,500 square foot building are leased from Marjorie S. Brooks, a major shareholder, under an agreement which expires April 30, 2001. The Company owns the building and other improvements located on the site and currently pays a monthly rent of \$1,519 for the lease. The Company believes that the Junction facility is currently suitable for its composite materials manufacturing requirements, however, the Company is evaluating ways to establish additional composites capacity.

The Company's plastic reclamation facility is located in Rogers, Arkansas, where the Company leases 17,000 square feet for its manufacturing and warehouse facility and adjacent office space. This facility is being occupied under the provisions of a production lease which expires January 1, 1997 and contains five automatic renewal options of one year each. The lease agreement does not require any minimum lease payments, but requires payments based on plant production at a rate of \$.02 per pound. This rental arrangement will remain in effect for any such renewal periods as well. The Company paid rent of \$105,717 for this facility during the year ended December 31, 1995.

The Company's corporate offices are located in a leased office-warehouse complex in Springdale, Arkansas. The facility consists of a 20,000 square foot building with an adjoining 10,000 square feet of paved and covered storage and rail spur access. The lease provides for a rental amount of \$5,000 per month, a term of four years beginning June 15, 1992, with a renewal option for two additional years. The Company is currently subleasing portions of the space to third parties for \$4,450 per month.

ITEM 3. 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.

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. 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.

In August 1994, Mobil filed a motion seeking an award of attorneys' fees and costs in the amount of \$2.7 million. On November 1, 1994, the Court ruled that the motion was premature and will not be considered at the present time. In January 1995, Mobil renewed its Motion for Attorneys' Fees. In April 1995, the Court requested AERT to respond to Mobil's Motion. The Motion is currently pending. The Company will vigorously defend against Mobil's claim for attorneys' fees and costs, however, there can be no assurances as to the outcome of this litigation.

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted by the Company to a vote of security holders during the quarter ended December 31, 1995.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

As of March 6, 1996, the Company's Class A Common Stock and the Company's Redeemable Class B Warrants are traded in the over-the-counter market and are listed on NASDAQ under the symbols AERTA and AERTZ, respectively.

The following table sets forth the ranges of high and low bid prices (as reported by NASDAQ) of the Company's Class A Common Stock and Redeemable Class B Warrants, for the years ended December 31, 1993, 1994 and 1995. The quotations represent prices between dealers and do not include retail markup, markdown or commission, and do not necessarily represent actual transactions.

	Class A		Class B	
	Common Stock	Warrants	High	Low
	High	Low	High	Low
	-----	-----	-----	-----
Fiscal 1993				
First Quarter	1.94	1.25	.44	.25
Second Quarter	1.81	.81	.38	.16
Third Quarter	1.50	1.00	.19	.16
Fourth Quarter	1.50	1.12	.19	.12
Fiscal 1994				
First Quarter	2.19	.50	.13	.03
Second Quarter	.88	.44	.03	.03
Third Quarter	.50	.19	.03	.03
Fourth Quarter	.56	.25	.06	.03
Fiscal 1995				
First Quarter	.53	.32	.06	.03
Second Quarter	2.06	.34	.*	.*
Third Quarter	2.00	1.00	.56	.13
Fourth Quarter	1.50	.94	.25	.09

* - No established public trading market.

As of March 5, 1996, there were 1,479 record holders of Class A Common Stock and 11 record holders of Class B Common Stock. The number of beneficial owners of the Class A Common Stock at March 5, 1996 is not known; however, based on inquiries to certain brokers, management believes the number of the beneficial owners of Class A Common Stock at March 5, 1996 was in excess of 5,000.

ITEM 6. SELECTED FINANCIAL DATA

The following tables set forth selected historical data for the Company for the years ended December 31, 1991 through 1995. For the year ended December 31, 1995, the data was obtained from the Company financial statements contained in this document at pages F-1 through F-24. Data for the periods prior to December 31, 1995 was obtained from Item 6 of the Company's Annual Report or Form 10-K for the year ended December 31, 1994.

STATEMENTS OF OPERATIONS DATA:

	YEAR ENDED DEC. 31, 1995	YEAR ENDED DEC. 31, 1994	YEAR ENDED DEC. 31, 1993	YEAR ENDED DEC. 31, 1992	YEAR ENDED DEC. 31, 1991
Sales	\$ 5,581,172	\$ 3,675,018	\$ 2,043,476	\$ 559,886	\$ 127,213
Net Loss before extraordinary gain	(2,756,263)	(2,970,135)	-	-	-
Extraordinary gain	-	879,373	-	-	-
Net Loss	(2,756,263)	(2,090,762)	(3,692,773)	(3,241,158)	(1,655,290)
Net Loss before extraordinary gain per common share	(.17)	(.21)	-	-	-
Extraordinary gain per common share	-	.06	-	-	-
Net Loss Per common share/(1)/	(.17)	(.15)	(.34)	(.34)	(.26)
Weighted Average Number of Shares Outstanding/(1)/	15,779,721	14,166,869	10,853,938	9,579,858	6,346,877

BALANCE SHEET DATA:

	Dec. 31, 1995	Dec. 31, 1994	Dec. 31, 1993	Dec. 31, 1992	Dec. 31, 1991
WORKING CAPITAL (DEFICIT)	\$(1,556,805)	\$ (599,753)	\$ (701,142)	\$ 812,199	\$ (875,295)
TOTAL ASSETS	7,357,742	8,781,907	9,146,981	9,925,393	5,148,531
LONG-TERM DEBT	1,266,642	1,844,597	892,294	598,129	746,134
TOTAL LIABILITIES	3,643,999	3,335,459	3,010,529	1,698,484	1,833,195
STOCK SUBSCRIPTION			1,000,000		
STOCKHOLDERS' EQUITY	\$ 3,713,743	\$5,446,448	\$5,136,452	\$8,226,909	\$3,315,336

(1) The net loss per share of common stock is based on the combined weighted average 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 in November 1989 (common stock equivalents) were not considered as outstanding after the date of the public offering since they were contingently cancelable if certain conditions did not occur. On March 31, 1995, all shares of Class B common stock held in escrow were cancelled.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Year Ended December 31, 1995 Compared To Year Ended December 31, 1994

Net sales increased to \$5,581,172 for the year ended December 31, 1995 which represented an increase of \$1,906,154 or 52% over the year ended December 31, 1994. Sales from the composites manufacturing unit were \$4,532,748 in 1995 compared to \$3,049,013 for 1994 a 48% increase. 1995 composites sales consisted of door and window component sales of \$3,770,569, decking material sales of \$762,179 and industrial flooring sales of \$395,252.

Increased volume from the composite manufacturing unit was the result of increased production achieved through reduced scrap rates and increased efficiencies in the Company's milling and painting departments, as well as sales to new customers. Additionally, in the middle of the second quarter, the Company added another production shift at the Junction Facility. The price decrease in the Company's composite products was attributable to a significant decrease in the price of competing wood products. Additionally, composites sales were affected by a drop-off in U.S. residential construction starts in February and March 1995, which resulted in slower door and window sales in the first and second quarter.

Sales of recycled plastics were \$1,048,424 in 1995 compared to \$626,005 in 1994. The increase in recycled plastics was primarily attributable to increased sales prices and increased short-term demand for recycled plastics due to higher prices of virgin resins during the first half of 1995. Sales dropped significantly beginning in the third quarter of 1995 due to the loss of a substantial customer.

Cost of goods sold was \$6,183,924 for 1995 compared to \$4,921,378 for 1994. The overall cost of goods sold to sales ratio, although still negative, showed improvement over 1994. The increase in cost of goods sold was primarily attributable increased raw material, labor costs, and poor operating efficiencies at the Rogers Facility. Significant categories are as follows:

Expense Category	1995	1994
Payroll and payroll taxes	\$2,169,987	\$2,016,990
Depreciation	1,043,804	865,194
Raw Materials	858,058	545,509
Other	2,112,075	1,493,685
Total	\$6,183,924	\$4,921,378

Selling, General and Administrative expenses during 1995 were \$1,356,244 compared to \$1,513,234 for 1994. The decrease in Selling, General and Administrative expenses is primarily attributable to decreased legal expenses.

The net loss for 1995 was \$2,756,263 or a net loss per weighted average common share outstanding of \$.17. This compares to a loss of \$2,090,762 or a net loss per weighted average common share outstanding of \$.15

for 1994 which included an extraordinary gain in the amount of \$879,373. The operating loss before the gain was \$2,970,135 or \$.21 per share.

Composites sales for the 4th Quarter of 1995 were limited by equipment and manufacturing problems caused by tramp metal getting into both extrusion systems during that quarter. This evaded the Company's cleaning and safety systems and resulted in down-time, maintenance, repair costs, and bad scrap rates. Law enforcement agencies are currently investigating whether these incidents were intentional. The Company has taken additional security measures, including installation of surveillance cameras, which are intended to better protect the Company's facilities, however there can be no assurance that such incidents will not continue to adversely impact the Company's operations.

Through 1995, the Company's plastics reclamation facility was involved in sales of recycled plastics to third-party film manufacturers. The materials desired by these customers required substantial processing beyond that necessary to produce raw-materials for the composites facility and were never efficiently produced. This, coupled with increased sales 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 to produce raw-materials and for additional equipment necessary to complete the installation of a third production line at the Company's composite facility.

Although Management believes that operating losses will continue into the 1st Quarter of 1996, substantial reductions of unit production costs at the Rogers facility are expected as a result of discontinuing those processes associated with the reclamation of plastics for outside sales. Further, sales of the Company's composite products are expected to increase as a result of this increased production capacity to be provided by the installation of the third line at the Junction facility, which is scheduled for completion during the 2nd Quarter of 1996. However, management continues to believe that for the Company to ultimately attain profitability, it must, in addition to increasing plant capacity, improve efficiencies and reduce overhead.

Year Ended December 31, 1994 Compared To Year Ended December 31, 1993

Net sales increased 80% from \$2,043,476 for the year ended December 31, 1993 to \$3,675,018 for the year ended December 31, 1994. This increase is attributable to significant increases in sales of the Company's Composite Product division. Composite product sales of \$3,049,013 for 1994 represented a 158% increase over the \$1,181,804 in sales for 1993. This increase is attributable to additions to the Company's customer base and increased sales to existing customers. This increase was achieved despite problems associated with raw materials and the interruption in production resulting from a major fire at the Junction, Texas facility during August of 1993. Limited production capabilities in the facility resumed in September 1993, although only one extrusion line produced product through August 1994. The damage to its composites facility also restricted the Company's ability to supply certain composite products to its customers. Plastic reclamation sales decreased from \$861,672 in 1993 to \$626,005 in 1994.

Cost of goods sold for the year-ended December 31, 1994 was \$4,921,378 compared to \$4,021,901 for 1993 which reflects an increase of \$899,477. The most significant reason for this increase was increased production and sales of the composite products division. Significant expense categories were as follows:

Expense Category	1994	1993
Payroll and payroll taxes	\$2,016,991	\$1,732,298
Depreciation	865,195	664,009
Raw Materials	545,507	416,526
Other	1,493,685	1,209,063
Total	\$4,921,378	\$4,021,901

Selling and Administrative Costs decreased slightly from \$1,567,899 for the year-ended December 31, 1993 to \$1,513,254 for 1994. While payroll-related expenses, depreciation and other expenses decreased significantly, this decrease was offset by substantial legal expenses related to the Mobil lawsuit.

In March 1994, Dow Chemical and the Company reached an agreement whereby Dow Chemical's obligation to purchase material from the Company (10 million pounds of the Company's recycled plastic bag film resins) was terminated. In consideration for this release, Dow forgave the repayment of the \$456,158 outstanding advance payment. In addition, Dow Chemical paid the Dow Credit Corporation and forgave the Company's outstanding balance of \$359,998 principal plus accrued interest under a loan agreement between Dow Credit and the Company. Further provisions of the agreement include the contribution in the amount of \$50,000 of Dow-owned laboratory equipment to the Company and continued technical assistance from Dow Chemical. Accordingly, the Company has recognized an extraordinary gain primarily from the retirement of debt in the amount of \$879,373.

The net loss for the year ended December 31, 1994 was \$2,090,762, or \$.15 per share. This compares with a loss of \$3,692,773, or \$.34 per share, for the year ended December 31, 1993.

Liquidity and Capital Resources

At December 31, 1995, the Company had a working capital deficit of \$1,566,805 compared to a working capital deficit of \$599,753 at December 31, 1994. The increased deficit is primarily attributable to the Company's 1995 operating loss and an increase in current maturities of long-term debt. Cash and cash equivalents increased \$9,373 in 1995. Significant components of that increase were: (i) cash used in operating activities of \$487,516, which consisted of the net loss for the period of \$2,756,263 reduced by depreciation and amortization of \$1,107,537, loss on disposition of equipment of \$527,804, and other uses of cash of \$633,406; (ii) cash used in investing activities of \$243,603, and (iii) cash provided by financing activities of \$740,492. Payments on notes during the period were \$1,351,276 and proceeds from the issuances of notes amounted to \$1,068,210. \$903,874 of such proceeds were provided by the Company's major stockholders, Jim and Marjorie Brooks (the "Major Stockholders") under the line of credit described below (see also Note 6 to Financial Statements). At December 31, 1995, the Company had notes payable in the amount of \$2,036,822, of which \$770,180 were current notes payable or current portion of long-term debt. On November 1, 1995,

the Major Stockholders and certain non-affiliated shareholders exercised 1,630,496 Class F Warrants. The proceeds from the exercise of these warrants, which amounted to \$994,603, reduced the working capital deficit of the Company and were used to reduce current liabilities. In January 1996, the major stockholder exercised 500,000 Class F Warrants which provided an additional \$305,000.

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 December 31, 1995, approximately \$65,000 was available to factor additional receivables. The Company also secured a line of credit from the Major Stockholders during 1994 which provided approximately \$981,000 of additional cash for general corporate purposes through January 1995. In February 1995, this obligation was restructured, converting the amount previously advanced as of that date (\$1,566,903) into long-term note payable and providing an additional \$433,097 revolving line of credit to be available as needed. As of December 31, 1995, the total amount of the line was available.

The Company currently does not have additional commitments for financing beyond the sources described immediately above and revenues have not historically been sufficient to support operational needs. However, the Company believes that if it can improve the production rates and efficiencies it is experiencing as of the date of this filing in conjunction with refocusing its Plastics Unit and streamlining overhead, it will be able to achieve a level of operations in periods subsequent to the first quarter of 1996 and thereafter which will significantly reduce or eliminate the need for additional sources of capital to support its operations. Management believes that increased sales obtained with a third composites line in conjunction with reduced plastics division costs will allow it to attain profitability. As such, the Company believes it will be able to continue operating as a going concern for at least the following twelve months. Continued improvements in production efficiency and capacity as previously discussed will be required for the Company to increase sales levels to those necessary to attain profitable results of operations and provide funds to repay the Company's outstanding obligations. There can be no assurance that such improvements in production efficiency or capacity will be achieved by the Company.

While it is not anticipated that significant additional capital expenditures will be required to support existing plant capacity, management is currently evaluating plans to better position the Company to address potential increasing sales opportunities on a timely basis. This could require significant additional composite production capacity beyond that of the existing Junction facility and require additional funds for capital expenditures. Therefore, the Company is currently evaluating a potential licensing or joint-venture arrangement for additional composite manufacturing capacity. The Company is also evaluating potential debt financing for additional manufacturing expansion. The Company has limited sources of equity financing to fund such capital expenditures, if necessary. One such source of financing could consist of certain of the Company's outstanding warrants. 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 has been extended to September 1, 1996. The Company also has outstanding 1,167,584 Private Placement Warrants held by non-affiliated entities, which, if exercised by holders, could generate equity capital for the Company (See Note 10 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.

The foregoing plan is not intended to satisfy the long-term cash needs of the Company; rather the plan assumes that the Company will achieve and maintain positive operating cash flows throughout the future. 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 17 to the financial statements, it is likely the Company will be unable to continue as a going concern. (See Note 2 to the accompanying financial statements)

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The response to this item is submitted in a separate section of this report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There have been no disagreements on accounting and financial disclosures with accountants during the periods reported upon herein.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The directors and executive officers of the Company are as follows:

NAME ----	AGE ---	POSITION -----
Sal Miwa	38	Chairman of the Board
Joe G. Brooks	40	President and Director
David C. Chapman	52	Secretary, Treasurer and Chief Financial Officer
Robert D. Gorsche	44	Chief Operating Officer
J. Douglas Brooks	36	Vice President
Marjorie S. Brooks	60	Director
Jerry B. Burkett	40	Director
Steve W. Brooks	39	Director

Chairman of the Board and Chief Executive Officer Jim G. Brooks passed away unexpectedly on January 16, 1996.

On January 30, 1996, Sal Miwa was elected as its Chairman by the Company's Board of Directors to serve the remaining term of the late Jim Brooks. Mr. Miwa has been an outside director of the Company for the past two years. Sal Miwa is President of Optro-Mechanics (USA) Corporation, an import-export firm located in Pearl River, New York. For the past 15 years he has been engaged in various international businesses and serves as a director and an officer of various other family owned businesses located in U.S., Japan, and Europe. He received his Science Master degree in Aerospace Engineering from the Massachusetts Institute of Technology.

Joe G. Brooks has served as President, Chief Executive Officer (until September 28, 1993) and a director since the Company's inception in December 1988. From July 1985 to December 1988, Mr. Brooks also served as President and a director of Juniper Products, Inc. (July 1985 - February 1987) and served as an independent consultant to Juniper Industries, Inc. (February 1987 - December 1988), artificial firelog manufacturing entities in Junction, Texas. See "Certain Transactions." From October 1984 to July 1985, Mr. Brooks served as President of Southern Minerals and Fibers, Inc. ("SMF"), a producer of drilling mud and fluid additives.

David C. Chapman joined the Company on October 18, 1993 as Chief Financial Officer, and on June 17, 1994, was also elected as the Company's Secretary and Treasurer. A Certified Public Accountant since 1973, Mr. Chapman has extensive public accounting experience and has served as controller or chief financial officer in both privately held and publicly owned companies in the transportation and financial industries.

Robert D. Gorsche joined the Company on February 13, 1995. As Chief Operating Officer, he assumes day-to-day control and operating responsibilities over the Company's composite manufacturing facility in Junction, Texas, and the plastics reclamation facility in Rogers, Arkansas. Mr. Gorsche has extensive technical and

manufacturing experience, including a Bachelor of Science degree from MIT in Cambridge, Massachusetts. His educational background also includes graduate studies at Northeastern University. Mr. Gorsche was previously employed at Therma-Tru Corporation of Maumee, Ohio, where he served as General Manager of the Indiana manufacturing operations and later as Vice President of Manufacturing.

J. Douglas Brooks has served as Vice President and a director of the Company from inception in December 1988 until June 17, 1994, and continues to serve as Vice President of Recycled Plastics. Mr. Brooks also served as an independent consultant to Juniper Industries, Inc. from April 1987 to December 1988 and as Vice President of SMF from September 1984 to April 1987.

Marjorie S. Brooks served as Secretary and Treasurer and a director since the Company's inception in December 1988. On March 9, 1993, Mrs. Brooks submitted her resignation as a director for personal health reasons. Mrs. Brooks also serves as a director of Juniper Industries, Inc. and Razorback Farms, Inc., has served as Secretary and Treasurer of the Brooks Investment Co., a holding company for the Brooks' family investments, for more than the past thirty years, and has served as President of Haskell Foods, Inc. from 1981 to the present.

Jerry B. Burkett was appointed to the Board of Directors of the Company on May 17, 1993. Mr. Burkett has been a rice and grain farmer since 1979 and has been a principal in other closely held businesses. He is currently the President of the Arkansas County Farm Bureau.

Steven W. Brooks was appointed to the Board of Directors of the Company on January 30, 1996. Mr. Brooks is President of Razorback Farms, Inc., a Springdale, Arkansas based firm that specializes in vegetables for processing. Mr. Brooks also serves on the Boards of Razorback Farms, Inc. and The Ozark Food Processors Association.

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

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

The Audit Committee of the Board of Directors consists of Jerry B. Burkett (Chairman), Joe G. Brooks, and Sal Miwa. The Audit Committee recommends engagement of the Company's independent accountants and is primarily responsible for approving the services performed by the Company's independent accountants and for reviewing and evaluating the Company's accounting principles and its system of internal accounting controls.

The Stock Option Committee, consists of Jerry B. Burkett (Chairman), Sal Miwa, and Marjorie S. Brooks. The Stock Option Committee administers the Company's stock option plans on behalf of the Board of Directors and approves stock options granted thereunder.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth the aggregate cash compensation paid by the Company during the three years ended December 31, 1995 to each executive officer of the Company whose aggregate cash compensation exceeded \$100,000, and to the chief executive officer.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation			
		Salary	Bonus	Other Annual Compensation	Awards		Payouts	
					Restricted Stock Awards	Securities Underlying Options	Long-Term Incentive Payouts	All Other Compensation
Jim G. Brooks, Chief Executive Officer (9/28/93) and Chairman of the Board of Directors	1995	\$ 0	\$0	\$ 0	\$0	0	\$0	\$0
	1994	0	0	0	0	500,000	0	0
	1993	0	0	0	0	25,000	0	0
Joe G. Brooks, Chief Executive Officer (to 9/28/ 93) and President	1993	\$70,919	\$0	\$1,200	\$0	\$ 0	\$0	\$0

**AGGREGATED OPTION EXERCISES IN YEAR ENDED DECEMBER 31, 1995
AND OPTION VALUES AT DECEMBER 31, 1995**

Name	Number of Shares Acquired on Exercise	Value Realized	Number of Unexercised Options at December 31, 1995 Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options at December 31, 1995 Exercisable/ Unexercisable
Jim G. Brooks	0	\$0	125,000/400,000	\$0/\$0

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Board of Directors of the Company does not currently maintain a Compensation Committee. Accordingly, the Board of Directors, as a whole, reviews and acts upon personnel policies and executive compensation matters. Two members of the Board of Directors, Jim G. Brooks and Joe G. Brooks, also serve as executive officers of the Company; however such individuals do not participate in compensation decisions or in forming compensation policies in which they have a personal interest, nor do they vote on any such matter.

LIMITED LIABILITY OF OFFICERS AND DIRECTORS

The Delaware Supreme Court has held that a director's duty of care to a corporation and its stockholders requires the exercise of an informed business judgment. Having become informed of all material information reasonably available to them, directors must act with requisite care in the discharge of their duties. The Delaware General Corporation law permits a corporation through its Certificate of Incorporation to exonerate its directors from personal liability to the corporation or its stockholders for monetary damages for breach of the fiduciary duty of care as a director, with certain exceptions. The exceptions include a breach of the director's duty of loyalty, acts or omissions not in good faith or which involve intentional misconduct or knowing violations of law, improper declarations of dividends and transactions from which the directors derived an improper personal benefit. The Company's Certificate of Incorporation exonerates its directors, acting in such capacity, from monetary liability to the extent permitted by this statutory provision. The limitation of liability provision does not eliminate a stockholder's right to seek nonmonetary, equitable remedies such as injunction or rescission to redress an action taken by directors. However, as a practical matter, equitable remedies may not be available in all situations and there may be instances in which no effective remedy is available.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth, as of December 31, 1995, certain information with regard to the beneficial ownership of the Company's capital stock by each holder of 5% or more of the outstanding stock, by each director of the Company, and by all officers and directors as a group:

Name and Address of Beneficial Owner	Title of Class(1)	Number of Shares of Common Stock(2)	Percentage of Class Outstanding(2)(9)	Percentage of Voting Power (2)(9)
Jim G. and Marjorie S. Brooks P.O. Box 1237 Springdale, AR 72764	Class A	11,025,795 (3)	37.4%	41.3%
	Class B	837,588 (4)	57.2%	
Joe G. Brooks 950 North 2nd Street Rogers, AR 72756	Class A	166,385 (5)	*	4.1%
	Class B	266,896	18.2%	
J. Douglas Brooks 950 North 2nd Street Rogers, AR 72756	Class A	75,450 (6)	*	2.0%
	Class B	131,051	8.9%	
Jerry B. Burkett 1908 Oak Stuttgart, AR 72160	Class A	84,000 (7)	*	*
	Class B	33,311	*	
Sal Miwa One Blue Hill Plaza, Suite 815 Pearl River, NY 10965-8667	Class A	53,000 (8)	*	*
Steven W. Brooks P.O. Box 291 Springdale, AR 72765	Class A	10,000	*	1.2%
	Class B	89,311	6.1%	
All officers and directors as a group (six persons)	Class A	11,506,296	39.0%	49.7%
	Class B	1,358,157	92.7%	

* Less than 1%

(1) The Class B Common Stock is substantially identical to the Class A Common Stock, except that each share of Class B Common Stock has five votes per share and each share of Class A Common Stock has one vote per share.

(2) Beneficial ownership of shares determined in accordance with Rule 13d-3(d)(1) of the Exchange Act and includes shares underlying outstanding warrants and options which the named individual has the right to acquire within sixty days of December 31, 1995.

(3) Includes 4,023,715 shares owned directly, 200,000 shares issuable upon exercise of stock options, 3,000 shares issuable upon exercise of Class B Warrants, 325,000 shares issuable upon exercise of Class C Warrants issued in connection with a \$225,000 Bridge Note purchased in 1993, 5,036,304 shares issuable upon exercise of Class F and Class G Warrants issued in connection with a private placement of Class A Common Stock in May of 1994 and 2,000,000 shares issuable upon exercise of Class H Warrants.

(4) Includes 403,946 shares owned directly by Mrs. Brooks and 433,642 shares owned by two corporations controlled by Mr. and Mrs. Brooks. (Razorback Farms, Inc. is the record owner of 312,320 shares and SMF is the record owner of 121,322 shares, representing approximately 21.3% and 8.3%, respectively, of the Class B Common Stock). Excludes additional shares owned by adult children of Mr. and Mrs. Brooks, including Joe G. Brooks and J. Douglas Brooks, as to which she disclaims a beneficial interest.

(5) Includes 86,552 shares owned directly, 3,000 shares owned as custodian for Mr. Brook's minor child, 43,500 shares issuable upon exercise of Class B Warrants owned directly and as custodian for Mr. Brook's minor child and 33,333 shares issuable upon exercise of stock options.

(6) Includes 34,997 shares owned directly, 7,620 shares issuable upon exercise of Class B Warrants and 33,333 shares issuable upon exercise of stock options.

(7) Includes 3,000 shares owned directly, 2,000 shares owned by Mr. Burkett as custodian for his minor child, 10,000 shares owned by a partnership controlled by Mr. Burkett, 19,000 shares issuable upon exercise of Class B Warrants directly and indirectly owned by Mr. Burkett and 50,000 shares issuable upon exercise of stock options.

(8) Includes 3,000 shares owned directly and 50,000 shares issuable upon exercise of stock options.

(9) Calculated based on 29,484,970 shares outstanding as of December 31, 1995, which includes 13,792,104 shares which any person has the right to acquire through the exercise of options and warrants within 60 days of December 31, 1995.

At March 5, 1996, there were 16,192,866 shares of Class A Common Stock and 1,465,530 shares of Class B Common Stock issued and outstanding. At that date, the directors and officers as a group directly owned shares representing approximately 48.7% of the votes entitled to be cast upon matters submitted to a vote of the Company's stockholders, and Jim G. and Marjorie S. Brooks and corporations controlled by them owned shares representing approximately 36.6% of the votes entitled to be cast and may be in a position to control the Company.

ESCROW SHARES

In connection with the Company's initial public offering, and at the request of D.H. Blair, the underwriter in such offering, the holders of the Company's Class B Common Stock agreed with the Company to place in escrow an aggregate of 5,625,000 shares of the Company's Class B Common Stock (the "Escrowed Shares") pursuant to an escrow agreement with the Company and American Stock Transfer & Trust Company as escrow agent. Such shares were placed in escrow by each holder of Class B Common Stock on a pro rate basis according to their respective holdings. Upon the occurrence of certain events, the Escrowed 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 \$16 million or (2) the market price of the Company's Class A Common Stock averaged in excess of \$6.50 per share for twenty 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 cancelled.

ITEM 13. CERTAIN TRANSACTIONS

In June and September, 1993 the Company secured short-term financing from Jim G. and Marjorie Brooks resulting in notes payable totaling \$136,000. The notes accrued interest at a rate of 8.0% per annum and were repaid in October, 1993. On October 13, 1993, Jim G. and Marjorie S. Brooks placed a \$1,000,000 non-refundable stock subscription prepayment with the Company in relation to the offering previously discussed. See "Liquidity and Capital Resources" in Item 7. The prepayment bears interest at the rate of 8% per annum which is payable on demand.

On June 29, 1993 the Company circulated a private placement offering of up to \$1,200,000 in Bridge Notes and Class C Warrants. The Notes are secured by certain equipment of the Company's composite production division, bear interest at the rate of 8% per annum, and mature June 29, 1994. The face amount of each Bridge Note is accompanied with an equal number of 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. Jim G. and Marjorie Brooks participated in the Bridge Offering in the amount of \$225,000.

In April 1994, the Company renewed an agreement with an affiliate whereby the Company agreed to sell certain of its trade receivables which the affiliate deems acceptable, up to \$650,000 at any one time. Upon 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 1995, the Company sold an aggregate of approximately \$5,852,000 in receivables under this agreement, of which \$241,723 remains to be collected. During 1994 and 1993, the Company sold an aggregate of approximately \$3,726,000 and \$1,018,000, respectively, in receivables under this agreement, none of which remains to be collected. Costs of approximately \$51,000, \$32,800 and \$9,000 associated with the factoring agreement are included in selling, production, general and administrative expenses at December 31, 1995, 1994 and 1993, respectively.

In July 1994, the Company obtained a \$1,000,000 secured line of credit bearing interest at the rate of 8.5% per annum from Jim G. and Marjorie S. Brooks at December 31, 1994 the Brooks had advanced the \$1,000,000 plus an additional \$411,903. In February 1995, the line of credit was increased to \$2,000,000 of which \$1,566,903 is a term-note to be amortized at 9.75% over five years beginning April 1, 1995 and the balance of \$433,097 is a revolving credit line expiring in February 2000 available as needed by the Company.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) 1,2 and (d). The Financial Statements listed in the accompanying Index to Financial Statements are filed as part of this report and such Index is hereby incorporated by reference. All schedules for which provision is made in the applicable accounting regulation on the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

(a) 3 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.

(b) No reports on Form 8-K were filed during the last quarter of the period covered by this report.

SIGNATURES

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, in the City of Springdale, State of Arkansas, on the 29th day of March, 1996.

**ADVANCED ENVIRONMENTAL RECYCLING
TECHNOLOGIES, INC.**

BY: /S/ Joe G. Brooks

/S/ David C. Chapman

JOE G. BROOKS,
President

DAVID C. CHAPMAN,
Secretary, Treasurer and Chief
Financial Officer

Date: March 29, 1996

March 29, 1996

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

<i>Signature</i>	<i>Title</i>	<i>Date</i>
-----	-----	-----
/S/ Sal Miwa ----- SAL MIWA	Chairman of the Board	March 29, 1996
/S/ Joe G. Brooks ----- JOE G. BROOKS	President and Director	March 29, 1996
/S/ Jerry B. Burkett ----- JERRY B. BURKETT	Director	March 29, 1996
/S/ Steven W. Brooks ----- STEVEN W. BROOKS	Director	March 29, 1996
/S/ Marjorie S. Brooks ----- MARJORIE S. BROOKS	Director	March 29, 1996

INDEX TO EXHIBITS

Exhibit No.	Description of Exhibit	Sequential Page Number
3.1	Certificate of Incorporation, including Certificate of Amendment filed on June 12, 1989(a), and Certificate of Amendment filed on August 22, 1989.(b)	
3.2	Certificate of Designation of Class B Common Stock.(a)	
3.3	Bylaws of Registrant.(a)	
4.1	Form of Class A Common Stock Certificate.(c)	
4.2	Form of Class B Common Stock Certificate.(a)	
4.3	Form of Warrant Agreement with American Stock Transfer & Trust Company, including Class A and Class B Common Stock Purchase Warrants.(a)	
4.7	Form of Redeemable Class B Warrant Certificate.(c)	
4.8	Form of Class C Warrant Certificate.(h)	
4.9	Form of Class D Warrant Certificate.(h)	
4.10	Form of Class E Warrant Certificate.(h)	
4.11	Form of Class F Warrant Certificate.(i)	
4.12	Form of Class G Warrant Certificate.(i)	
10.9	Form of Right of Refusal Agreement among Class B Common Stockholders.(a)	
10.10	1989 Stock Option plan.(a)	
10.11	Form of Escrow Agreement with American Stock Transfer & Trust Company.(c)	
10.15	Lease Agreement dated June 1, 1990 between the Registrant and J's Feed, Inc. for the Registrant's plastics reclamation facility.(e)	
10.16	Loan Agreement dated June 13, 1991 with Dow Credit Corporation.(f)	
10.16	Loan Agreement dated October 22, 1991 with Dow Credit Corporation.(f)	
10.16	Loan Agreement with City of Rogers, arranged through Arkansas Industrial Development Commission.(f)	
10.17	Lease Agreement dated June 15, 1992 between the Registrant and George's, Inc. for the Registrant's corporate office facility.(g)	
10.18	Factoring Agreement dated April 30, 1993 between the Registrant and Brooks Investment Company.(h)	
10.23	Private Placement Distribution Agreement dated September 23, 1993 between the Registrant and Berkshire International Finance, Inc.(h)	
10.26	Lease Agreement dated June 16, 1994 between Registrant and Marjorie S. Brooks.(i)	
10.27	Line of Credit Promissory Note payable to Jim G. Brooks and Marjorie S. Brooks.(i)	

10.28 Amended and Restated Stock Option Plan.(i)
10.29 Non-Employee Director Stock Option Plan.(i)
10.30 Chairman Stock Option Plan.(i)
10.31 Factoring Agreement dated April 30, 1994 between the Registrant and
Brooks Investment Company.(i)

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

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

(b) Contained in Exhibits to Amendment No. 1 to Registration Statement on Form S-1, No. 33-29595, filed August 24, 1989.

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

(d) Filed with Form 10-K for December 31, 1989.

(e) Filed with Form 10-K for December 31, 1990.

(f) Contained in Exhibits to Post Effective Amendment No. 1 to Registration Statement on Form S-1, No. 33- 29593, filed December 24, 1991.

(g) Filed with Form 10-K for December 31, 1992.

(h) Filed with Form 10-K for December 31, 1992.

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

ANNUAL REPORT ON FORM 10-K

ITEM 8, ITEM 14(A)(1) AND (2), (C) AND (D)

LIST OF FINANCIAL STATEMENTS

CERTAIN EXHIBITS

YEAR ENDED DECEMBER 31, 1995

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

SPRINGDALE, ARKANSAS

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

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

We have audited the accompanying balance sheets of Advanced Environmental Recycling Technologies, Inc. (a Delaware corporation), as of December 31, 1995 and 1994, and the related statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1995. 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 generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Advanced Environmental Recycling Technologies, Inc., as of December 31, 1995 and 1994, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1995, in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As reflected in the accompanying financial statements, the Company has not generated significant operating revenues, has incurred net losses since inception, has a working capital deficit at December 31, 1995, and is subject to certain claims in litigation as discussed in Note 17. Further, unaudited information subsequent to December 31, 1995, indicates that losses are continuing. These factors, among others, as discussed in Note 2, raise a substantial doubt about the ability of the Company to continue as a going concern. Management's plans in regards to those matters are also described in Note 2. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

ARTHUR ANDERSEN LLP

San Antonio, Texas
March 8, 1996

31 (F-2)

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS

	ASSETS	
	December 31, 1995	December 31, 1994
	-----	-----
Current assets:		
Cash and cash equivalents	\$ 15,350	\$ 5,977
Receivables	48,463	60,920
Inventories	648,211	710,694
Prepaid expenses and other	108,528	113,518
	-----	-----
Total current assets	820,552	891,109
	-----	-----
Buildings and equipment, at cost, including construction in progress of \$22,946 (1995) and \$201,608 (1994):		
Buildings	675,420	675,009
Machinery and equipment	7,985,870	8,405,688
Transportation equipment	112,411	112,411
Office equipment	170,659	166,278
Leasehold improvements	315,331	347,155
	-----	-----
	9,259,691	9,706,541
Less accumulated depreciation and amortization	3,050,979	2,129,348
	-----	-----
Net buildings and equipment	6,208,712	7,577,193
	-----	-----
Other assets, at cost less accumulated amortization of \$83,058 (1995) and \$59,801 (1994)	328,478	313,605
	-----	-----
	\$7,357,742	\$8,781,907
	=====	=====

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

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31, 1995	December 31, 1994
	-----	-----
Current liabilities:		
Current maturities of long-term debt	\$ 755,576	\$ 381,860
Accounts payable - trade	1,078,243	813,265
Accounts payable - related parties	362,155	58,415
Accrued liabilities	166,779	143,891
Notes payable	14,604	93,431
	-----	-----
Total current liabilities	2,377,357	1,490,862
	-----	-----
Long-term debt, less current maturities		
Related parties	1,102,554	1,241,249
Other	164,088	603,348
	-----	-----
Total long-term debt	1,266,642	1,844,597
	-----	-----
Commitments and contingencies		
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, 15,692,866 (1995) and 14,038,038 (1994) issued and outstanding	156,929	140,380
Class B convertible common stock, \$.01 par value; 7,500,000 shares authorized, 1,465,530 (1995) and 7,090,530 (1994) issued and outstanding	14,655	70,905
Additional paid-in capital	19,282,865	18,219,606
Accumulated deficit	(15,740,706)	(12,984,443)
	-----	-----
Total stockholders' equity	3,713,743	5,446,448
	-----	-----
	\$ 7,357,742	\$ 8,781,907
	=====	=====

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

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF OPERATIONS

	YEAR ENDED DECEMBER 31, 1995	YEAR ENDED DECEMBER 31, 1994	YEAR ENDED DECEMBER 31, 1993
Sales	\$ 5,581,172	\$ 3,675,018	\$ 2,043,476
Cost of Goods Sold	6,183,924	4,921,378	4,021,901
Gross Margin	(602,752)	(1,246,360)	(1,978,425)
Loss on Disposal of Assets	528,538	-	-
Selling and Administrative Costs	1,356,244	1,513,254	1,567,899
Operating Income (Loss)	(2,487,534)	(2,759,614)	(3,546,324)
Other Income (Expense)			
Other Income (Expense)	1,098	(19,716)	(11,269)
Interest Expense	(269,827)	(190,805)	(135,180)
Loss before extraordinary item	(2,756,263)	(2,970,135)	(3,692,773)
Extraordinary Gain	-	879,373	-
Net loss	\$(2,756,263)	\$(2,090,762)	\$(3,692,773)
Loss per share of common stock before extraordinary gain	(\$.17)	(\$.21)	(\$.34)
Extraordinary gain per share of common stock	-	(\$.06)	-
Net loss per share of common stock	(\$.17)	(\$.15)	(\$.34)
Weighted average number of common shares outstanding	15,779,721	14,166,869	10,853,938

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

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF STOCKHOLDERS' EQUITY

	Class A Common Stock	
	Shares	Amount
Balance - December 31, 1992	9,343,006	\$ 93,430
Net proceeds from issuance of Class A Common stock	736,135	7,361
Conversion of Class B Common Stock to Class A Common Stock	13,125	132
Net loss for the year ended December 31, 1993	-	-
Balance - December 31, 1993	10,092,266	100,923
Issuance of Class A Common stock		
Net loss for the year ended December 31, 1994	3,945,772	39,457
Balance - December 31, 1994		
Cancellation of 5,625,000 Shares of Class B Common Stock	14,038,038	\$140,380
Exercise of Stock Options		
Exercise of Class F Warrants		
Net loss for the year ended December 31, 1995	24,332	244
Balance - December 31, 1995	1,630,496	16,305
	15,692,866	\$156,929

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

Class B Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total
Shares	Amount			
7,103,655	\$ 71,037	\$15,263,350	\$ (7,200,908)	\$ 8,226,909
-	-	594,955	-	602,316
(13,125)	(132)	-	-	-
-	-	-	(3,692,773)	(3,692,773)
7,090,530	70,905	15,858,305	(10,893,681)	5,136,452
-	-	2,361,301	-	2,400,758
-	-	-	(2,090,762)	(2,090,762)
7,090,530	\$ 70,905	\$18,219,606	\$ (12,984,443)	\$ 5,446,448
(5,625,000)	(56,250)	56,250	-	-
-	-	28,711	-	28,955
-	-	978,298	-	994,603
-	-	-	(2,756,263)	(2,756,263)
1,465,530	\$ 14,655	\$19,282,865	\$ (15,740,706)	\$ 3,713,743

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.
STATEMENTS OF CASH FLOWS

	Year ended December 31, 1995	Year ended December 31, 1994	Year ended December 31, 1993
Cash flows from operating activities:			
Net loss	\$(2,756,263)	\$(2,090,762)	\$(3,692,773)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,084,280	938,126	716,676
Amortization of other assets	23,257	20,223	35,859
Fire loss, net	-	-	9,747
Loss on disposition of equipment	527,804	19,736	6,980
Increase in other assets	(38,130)	(49,624)	(85,144)
Changes in operating assets & operating liabilities	671,536	223,648	403,943
Extraordinary gain	-	(879,373)	-
Net cash used in operating activities	(487,516)	(1,818,026)	(2,604,712)
Cash flows from investing activities:			
Additions to buildings and equipment	(248,603)	(835,921)	(1,192,783)
Proceeds of sale of equipment	5,000	22,000	17,250
Insurance recoveries, net of fire related expenses	-	543,305	231,061
Net cash used in investing activities	(243,603)	(270,616)	(944,472)
Cash flows from financing activities:			
Prepaid Stock Subscriptions	-	-	1,000,000
Proceeds from issuance of notes	1,068,210	2,269,763	1,067,872
Payments on notes	(1,351,276)	(747,866)	(503,257)
Proceeds from issuance of common stock	-	380,341	614,189
Proceeds from warrant exercises, net	994,603	-	-
Offering and warrant exercise costs	-	-	(11,873)
Proceeds from exercise of stock options, net	28,955	-	-
Net cash provided by financing activities	740,492	1,902,238	2,166,931
Increase (Decrease) in cash & cash equivalents	9,373	(186,404)	(1,382,253)
Cash and cash equivalents:			
Beginning of period	5,977	192,381	1,574,634
End of period	\$ 15,350	\$ 5,977	\$ 192,381

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

NOTES TO FINANCIAL STATEMENTS

Note 1: Organization and description of the Company

Advanced Environmental Recycling Technologies, Inc. (the Company or AERT) has developed and manufactures composite building material from waste plastic and wood fiber waste for certain specialized applications in the construction industry. The Company markets this material as a substitute for wood and plastic filler materials for standard door frames, window sills, flooring, 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 was 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 such contributed amounts are reflected in the accompanying financial statements at the contributor's book value.

For periods prior to 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 2: 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 December 31, 1995, the Company had a working capital deficit of \$1,556,805 and had incurred net losses of \$2,756,263, \$2,090,762, and \$3,692,773 for the years ended December 31, 1995, 1994, and 1993, respectively. 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. Further, in January 1996, certain affiliated shareholders 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. 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 17, the outcome of which is uncertain. There can be no assurance that the Company's financial resources (which at present are limited to a \$433,000 line of credit as described in Note 7) 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 17 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 December 31, 1995. 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. As disclosed in Note 18, the Company is restructuring 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 nine 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 \$6,161,968 at December 31, 1995.

Note 3: Significant accounting policies

Statements of Cash Flows

In order to determine net cash used in operating activities, net loss has been adjusted by, among other things, changes in operating assets and operating liabilities, excluding changes in cash and cash equivalents, insurance claim advances receivable, 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:

	Year ended December 31, 1995	Year ended December 31, 1994	Year ended December 31, 1993
	-----	-----	-----
Receivables	\$ 12,457	\$ 83,709	\$ (38,469)
Inventories	62,483	(266,964)	(265,107)
Prepaid expenses and other	4,990	(11,198)	(39,911)
Accounts payable - trade & related parties	568,718	273,795	173,978
Accrued liabilities	22,888	147,164	114,436
Deferred revenue	-	(2,858)	459,016
	-----	-----	-----
	\$671,536	\$ 223,648	\$ 403,943
	=====	=====	=====

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 dispositions of property are credited or charged to income.

Provision for depreciation of buildings and equipment is provided on a straight- line basis for buildings and leasehold improvements, transportation equipment and office equipment over the lesser of the estimated useful life of the asset or the term of the lease. Machinery and equipment is depreciated on a straight- line basis over the estimated useful life of the asset or on a units of production basis over the estimated useful production life of the asset. 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:

	December 31, 1995	December 31, 1994
Raw materials	\$ 54,279	\$ 78,302
Finished goods	593,932	632,392
	-----	-----
	\$648,211	\$710,694
	=====	=====

Other assets

Other assets consist primarily of the costs for the preparation of patent applications (\$406,447 at December 31, 1995) 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.

Concentrations of Credit Risk

The Company's revenues are derived principally from a number of regional and national door and window manufacturers and Weyerhaeuser, the Company's primary decking customer. This industry concentration has the potential to impact the Company's exposure to credit risk because the customers may be similarly affected by changes in economic or other conditions in the construction industry.

Disclosure About Fair Value of Financial Instruments

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

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

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

Note 4: Receivables

The Company historically has experienced no bad debt expense and therefore has recorded no allowance for doubtful accounts at December 31, 1995 and 1994.

In April 1994, the Company renewed an agreement with an affiliate whereby the Company agreed to sell certain of its trade receivables which the affiliate deems acceptable, up to \$650,000 at any one time. Upon 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 1995, the Company sold an aggregate of approximately \$5,852,000 in receivables under this agreement, of which \$241,723 remains to be collected. During 1994 and 1993, the Company sold an aggregate of approximately \$3,726,000 and \$1,018,000, respectively, in receivables under this agreement, none of which remains to be collected. Costs of approximately \$51,000, \$32,800 and \$9,000 associated with the factoring agreement are included in selling, production, general and administrative expenses at December 31, 1995, 1994 and 1993, respectively.

Note 5: Deferred revenue

During the second quarter of 1993, the Company received a \$500,000 advance payment from The Dow Chemical Company (Dow) toward future purchases by Dow of recycled plastic bag film resins from the Company's Rogers, Arkansas plastic reclamation facility. At December 31, 1993, the Company had \$459,016 of such advance payment outstanding. In March 1994, this advance payment was forgiven by Dow. (See Note 15).

Note 6: Bridge notes payable

On June 29, 1993, the Company circulated a private placement offering up to \$1,200,000 in Bridge Notes and Class C Warrants. The notes were secured by certain equipment of the Company's composite products division, with accrued interest at the rate of 8% per annum, and matured June 29, 1994. The face amount of each Bridge Note was accompanied with an equal number of 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. The Company raised \$650,000 and issued 650,000 Class C Warrants in connection with this private placement offering which is included in notes payable and notes payable-related party at December 31, 1993. In May 1994, \$600,000 of the Bridge Notes were converted into Class A Common Stock as a portion of the Private Placement Offering discussed in Note 10. In July 1994, the remaining \$50,000 plus accrued interest was paid by the Company.

Note 7: 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 certain outstanding 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 \$1,566,903 is a term note to be amortized at 9 3/4% over five years beginning April 1, 1995 and the balance of \$433,097 is a revolving credit line to be available as needed by the Company. At December 31, 1995, the Company had no amounts outstanding under this line and \$433,097 was available for future borrowings. This revolving line of credit expires in February, 2000. Current maturities of long-term debt as of December 31, 1994 reflect the conversion of the line of credit to a long-term obligation as described above.

Note 8: Long-term debt

Long-term debt as of December 31, 1995 and December 31, 1994, consisted of the following:

	1995	1994
	-----	-----
Note payable, due in 23-monthly installments of \$10,156 plus interest at prime plus two percent (10.5% at December 31, 1995) beginning October 1, 1994 with the remaining balance due September 1, 1996; secured by certain manufacturing equipment, inventories and receivables. (See Note 15)	\$ 324,970	\$ 456,998
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.	213,769	258,823
Note payable, to a related party, due in 60-monthly installments of principal and interest, beginning April 1, 1995, interest at 9.75%.	1,399,245	1,411,903
Other	84,234	98,733
Total	----- 2,022,218	----- 2,226,457
Less current maturities	(755,576)	(381,860)
Long-term debt, net of current maturities	----- \$ 1,266,642 =====	----- \$1,844,597 =====

The fair value of the Company's outstanding debt is approximately equal to its carrying value at December 31, 1995.

The aggregate maturities of long-term debt as of December 31, 1995 are as follows:

1996	\$ 755,576
1997	451,194
1998	348,542
1999	369,199
2000	97,707
Thereafter	-

	\$2,022,218
	=====

Note 9: Interest

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

	Year ended December 31, 1995	Year ended December 31, 1994	Year ended December 31, 1993
	-----	-----	-----
Interest incurred	\$269,827	\$190,805	\$135,180
Interest capitalized as part of the cost of machinery and equipment	-	-	-
	-----	-----	-----
Interest expensed	\$269,827	\$190,805	\$135,180
	=====	=====	=====
Cash payments for interest	\$301,192	\$ 35,794	\$ 67,333
	=====	=====	=====

Note 10: 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 expire in November 1995.

The underwriter received a selling commission of 10% and a nonaccountable expense allowance of 3% of the gross offering proceeds. In addition, for \$125, the Company sold to the underwriter a unit purchase option to acquire up to 125,000 units for \$5.20 per unit. The units to be issuable upon exercise of the unit purchase option are identical to the public offering unit, except that warrants are not redeemable. The unit purchase option expired unexercised on November 8, 1994.

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 will continue to vote the escrow shares unless such shares are canceled. Upon the occurrence of certain events, escrow shares will be released from escrow and returned to the Class B Stockholders if during the calendar year ending December 31, 1994 (1) the Company's minimum pretax income is 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 and then canceled on March 31, 1995.

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 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 168,501 Class D Warrants as of December 31, 1993 and an additional 38,250 Class D Warrants during 1994 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 will be issued six months after the Class A Common shareholders' stock acquisition date, provided that the shares of Class A Common Stock are 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.

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, respectively, for each share of Class A Common Stock purchased.

In 1995, in connection with an extension of a line of credit to the Company by a related party (see Note 7), 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 2000.

At December 31, 1995, 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 11)	3,050,000
Class C Warrants	650,000
Class D Warrants	206,751
Class E Warrants	128,609
Class F Warrants	1,837,904
Class G Warrants	3,468,400
Class H Warrants	2,000,000

	15,554,104
	=====

Note 11: 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 employee, 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 April 1994, 25,000 such options were granted to each of the four outside directors serving on the Board at that time.

In June 1994, stockholders of the Company approved the adoption of the Amended and Restated Stock Option Plan which superseded 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.

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 year ended December 31, 1995 is as follows:

	Shares	Per Share
	-----	-----
Outstanding		
December 31, 1994	1,568,000	\$1.00 - \$3.00
Granted	406,000	\$.38
Forfeited	(18,000)	\$.72
Exercised	(24,332)	\$1.19

Outstanding		
December 31, 1995	1,931,668	\$.38 - \$3.00
Exercisable		
December 31, 1995	1,054,688	\$.38 - \$3.00
	=====	

Note 12: Leases

At December 31, 1995, the Company was obligated under a non-cancelable sublease with a principal stockholder for land on which a production facility is located. This lease, has an expiration date of April 30, 2001, and rental payments of \$1,519 per month. The Company also leases a production facility under an operating lease which expired January 1, 1995 and contains five automatic renewal options of one year each. The Company has executed the third of the renewal options. This lease agreement does not require any minimum lease payments but requires payments based on product shipments at a rate of \$.02 per pound. Additionally, the Company is obligated under a non-cancelable lease for office space at \$5,000 per month which expires on June 14, 1996 and contains a two-year renewal option. The Company is currently subleasing portions of the space for \$4,450 per month. At December 31, 1995, the Company was obligated under various operating leases covering certain equipment. Rent expense under operating leases for the years ended December 31, 1995, 1994, and 1993 was \$200,417, \$189,611 and \$199,715, respectively. Future minimum lease payments required under operating leases are as follows:

Fiscal Year	
1996	\$ 58,651
1997	29,144
1998	27,170
1999	19,554
2000	18,232
thereafter	6,077

Total minimum payments required	\$158,828
	=====

Note 13: Income taxes

Effective January 1, 1993, the Company adopted Statement of Financial Accounting Standards No.109 "Accounting for Income Taxes" (SFAS No. 109). The adoption of SFAS No. 109 had no effect on the Company's financial position or results of operations, as the Company has generated book and tax losses for the period from inception.

As of December 31, 1995, the Company had net operating loss carryforwards of approximately \$9.7 million for federal income tax purposes which are available to reduce future taxable income and will expire in 2003 through 2010 if not utilized and approximately \$15,800,000 for financial reporting purposes. For federal income tax purposes, the Company deferred for future amortization start-up costs in the amount of \$9.4 million. Such costs, which have been expensed for financial reporting purposes, are being amortized for tax purposes over future years.

The tax effects of significantly temporary differences representing deferred income tax assets and liabilities are as follows:

	December 31, 1995	December 31, 1994	December 31, 1993
Deferred income tax assets-			
Deferred start-up costs	\$ 2,200,000	\$ 2,550,000	\$ 2,884,000
Net operating loss carry forward	3,300,000	1,244,000	851,000
Valuation allowance	(4,800,000)	(3,130,000)	(3,105,000)
	-----	-----	-----
Total deferred income tax assets	\$ 700,000	\$ 664,000	\$ 630,000
	=====	=====	=====
Deferred income tax liabilities-			
Depreciation	\$ 700,000	\$ 664,000	\$ 630,000
	-----	-----	-----
Total deferred income tax liabilities	\$ 700,000	\$ 664,000	\$ 630,000
	=====	=====	=====

As the Company has generated net operating losses since its inception and there is no assurance of future income, a valuation allowance of \$4,800,000 has been established at December 31, 1995 to recognize its deferred tax assets only to the extent of its deferred tax liabilities. The Company will continue to evaluate the necessity for such valuation allowance in the future.

Note 14: Significant customer

During the year ended December 31, 1995, the Company had \$2,189,073 in sales to a single customer which represented 39% of total sales. Sales to this customer for the years ended December 31, 1994 and 1993 were \$2,487,802 (68%) and \$861,672 (42%), respectively. Additionally, the Company had sales of \$653,412 to another customer which represents 12% of total sales for the year ended December 31, 1995. There were no sales to this customer in 1994 or 1993.

Note 15: Extraordinary Gain

On March 18, 1994, Dow Chemical and the Company reached an agreement whereby Dow Chemical's obligation to purchase material from the Company (10 million pounds of the Company's recycled plastic bag film resins) was terminated. In consideration for this release, Dow forgave the repayment of the \$456,158 outstanding advance payment.

In addition, Dow Chemical paid the Dow Credit Corporation and forgave the Company's outstanding balance of \$359,998 principal plus accrued interest under the loan agreement dated October 22, 1991, amended as of January 23, 1993, between Dow Credit and the Company. Also the outstanding balance of \$440,000 principal plus accrued interest due Dow Credit under the loan agreement dated June 13, 1991, amended as of January 1, 1993 between Dow Credit and the Company was restructured whereby the Company will repay the entire principal balance due plus accrued interest. (See Note 8).

Further provisions of the agreement include the contribution in the amount of \$50,000 of Dow-owned laboratory equipment to the Company and continued technical assistance from Dow Chemical. Accordingly, the Company has recognized an extraordinary gain primarily from the retirement of debt in the amount of \$879,373 in the accompanying statement of operations.

Note 16: 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 and subsequently cancelled 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 A, B, C, D, E, F, G, and H Warrants issued or contingently issuable, and the stock options) have a dilutive effect on the loss per share calculation and, accordingly, were also excluded.

Had the May 1994 conversion of the various debt instruments into 3,468,400 shares of Class A Common Stock as discussed in Note 10 occurred effective at the later of the original issue date of the converted debt instruments or January 1, 1994, the net loss per share of common stock would have been \$(.13) for the year ended December 31, 1994.

Note 17: 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. 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.

In August 1994, Mobil filed a motion seeking an award of attorneys' fees and costs in the amount of \$2.7 million. On November 1, 1994, the Court ruled that the motion was premature and will not be considered at the present time. In January 1995, Mobil renewed its Motion for Attorneys' Fees. In April 1995, the Court requested AERT to respond to Mobil's Motion. The Motion is currently pending. The Company will vigorously defend against Mobil's claim for attorneys' fees and costs, however, there can be no assurances as to the outcome of this litigation.

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

Note 18: Loss on Disposal of Equipment

In connection with a restructuring of the Company's Rogers plastics reclamation plant, wherein the Company will discontinue reclamation of plastics for sale to third parties, the Company exchanged certain equipment, previously utilized to produce such plastics, for other equipment which will be utilized to produce raw materials for the manufacture of the Company's composite wood product and for additional manufacturing equipment for the composite production facility. The Company has accrued a loss at December 31, 1995, of \$528,538 which constitutes the difference between the net book value of the Company's investment in equipment and leasehold improvements dedicated to produce plastics for sale to third parties (\$666,038) and the fair value of the equipment received.

Sales of plastics to third parties were \$1,048,424, \$626,005, and \$861,672 for each of the years ended December 31, 1995, 1994, and 1993, respectively.

ARTICLE 5

PERIOD TYPE	YEAR
FISCAL YEAR END	DEC 31 1995
PERIOD START	JAN 01 1995
PERIOD END	DEC 31 1995
CASH	15,350
SECURITIES	0
RECEIVABLES	48,463
ALLOWANCES	0
INVENTORY	648,211
CURRENT ASSETS	820,552
PP&E	9,259,691
DEPRECIATION	3,050,979
TOTAL ASSETS	7,337,742
CURRENT LIABILITIES	2,337,357
BONDS	0
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	171,584
OTHER SE	3,542,159
TOTAL LIABILITY AND EQUITY	7,357,742
SALES	5,581,172
TOTAL REVENUES	5,581,172
CGS	6,183,924
TOTAL COSTS	8,068,706
OTHER EXPENSES	1,098
LOSS PROVISION	0
INTEREST EXPENSE	269,827
INCOME PRETAX	(2,756,263)
INCOME TAX	0
INCOME CONTINUING	(2,756,263)
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	(2,756,263)
EPS PRIMARY	(.17)
EPS DILUTED	(.17)

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