ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC
Form 10-Q
November 16, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2015

OR

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

Commission File Number 1-10367

Advanced Environmental Recycling Technologies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**71-0675758**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

914 N. Jefferson Street Springdale, Arkansas	**72764**
(Address of principal executive offices)	*(Zip Code)*

(479) 756-7400

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company þ
(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No þ

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of October 30, 2015, the number of shares outstanding of the Registrant's Class A common stock, which is the class registered under the Securities Exchange Act of 1934, was 89,631,162.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS

(In thousands)

	September 30, 2015 (unaudited)	December 31, 2014
Assets		
Current assets:		
Cash	$ 243	$ 112
Trade accounts receivable, net of allowance of $209 and $48 at September 30, 2015 and December 31, 2014, respectively	3,315	4,346
Accounts receivable - related party	26	26
Inventories	17,001	14,316
Prepaid expenses	1,606	1,134
Total current assets	22,191	19,934
Land, buildings and equipment:		
Land	2,220	2,220
Buildings and leasehold improvements	17,062	17,019
Machinery and equipment	55,344	52,267
Construction in progress	1,263	662
Total land, buildings and equipment	75,889	72,168
Less accumulated depreciation	48,064	45,080
Net land, buildings and equipment	27,825	27,088
Other assets:		
Debt issuance costs, net of amortization	205	483
Other assets, net of amortization	380	380
Total other assets	585	863
Total assets	$ 50,601	$ 47,885

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

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS *(continued)*

(In thousands, except share and per share data)

	September 30, 2015 (unaudited)	December 31, 2014
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable – trade	$ 6,480	$ 4,559
Accounts payable – related parties	90	25
Current maturities of long-term debt	5,849	5,240
Other accrued liabilities	4,214	3,865
Working capital line of credit	-	3,625
Total current liabilities	16,633	17,314
Long-term debt, less current maturities	34,988	32,470
Commitments and Contingencies (*See Note 9*)		
Series E cumulative convertible preferred stock, $0.01 par value; 30,000 shares authorized, 20,524 shares issued and outstanding at September 30, 2015 and December 31, 2014, including accrued unpaid dividends of $6,371 and $5,196 at September 30, 2015 and December 31, 2014, respectively	26,895	25,720
Stockholders' deficit:		
Class A common stock, $.01 par value; 525,000,000 shares authorized; 89,631,162 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	897	897
Additional paid-in capital	53,660	53,660
Accumulated deficit	(82,472)	(82,176)
Total stockholders' deficit	(27,915)	(27,619)
Total liabilities and stockholders' deficit	$ 50,601	$ 47,885

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

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except share and per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Net sales	$21,843	$20,724	$65,564	$61,961
Cost of goods sold	16,503	15,639	52,249	48,682
Gross margin	5,340	5,085	13,315	13,279
Selling and administrative costs	3,318	3,027	9,825	9,037
Gain from asset disposition	-	(50)	(1)	(64)
Operating income	2,022	2,108	3,491	4,306
Other income and expenses:				
Other income	2	12	12	11
Gain (loss) from involuntary conversion of non-monetary assets due to fire	-	(500)	-	345
Net interest expense	(853)	(779)	(2,624)	(2,372)
Net income	1,171	841	879	2,290
Dividends on preferred stock	(398)	(375)	(1,175)	(1,107)
Net income (loss) applicable to common stock	$773	$466	$(296)	$1,183
Income (loss) per share of common stock (basic and diluted)	$0.00	$0.00	$(0.00)	$0.00
Weighted average common shares outstanding (basic and diluted)	444,674,483	424,165,483	89,631,162	419,275,834

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

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ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Cash flows from operating activities:		
Net income (loss) applicable to common stock	$(296)	$ 1,183
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	3,734	3,070
Dividends on preferred stock	1,175	1,107
Accrued interest converted to long-term debt	2,100	1,917
Gain from asset disposition	(1)	(64)
Increase in accounts receivable allowance	161	2
Gain from involuntary conversion of non-monetary assets due to fire	-	(345)
Changes in other current assets and current liabilities	714	1,162
Net cash provided by operating activities	7,587	8,032
Cash flows from investing activities:		
Purchases of land, buildings and equipment	(1,723)	(1,587)
Proceeds from disposition of assets	4	71
Insurance proceeds from involuntary conversion of non-monetary assets due to fire	-	418
Net cash used in investing activities	(1,719)	(1,098)
Cash flows from financing activities:		
Payments on notes	(2,112)	(1,346)
Net payments on line of credit	(3,625)	(5,135)
Net cash used in financing activities	(5,737)	(6,481)
Increase in cash	131	453
Cash, beginning of period	112	124
Cash, end of period	$243	$ 577

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

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NOTES TO FINANCIAL STATEMENTS

Unaudited

Note 1: Unaudited Information

Advanced Environmental Recycling Technologies, Inc. (the Company, AERT, we, our or us) has prepared the financial statements included herein without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). However, all adjustments have been made to the accompanying financial statements, which are, in the opinion of the Company’s management, necessary for a fair presentation of the Company’s operating results. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted pursuant to such rules and regulations. Although the Company believes that the disclosures are adequate to make the information presented herein not misleading, it is recommended that these financial statements be read in conjunction with the financial statements and the notes thereto included in the Company’s latest annual report on Form 10-K. Interim reports, such as this one, however, are not necessarily indicative of results to be obtained for the full year.

Note 2: Description of the Company

AERT, founded in 1988, develops and commercializes technologies to recycle waste polyethylene plastics and develops, manufactures, and markets value-added, green building products. The majority of our products are composite building materials that are a superior replacement for traditional wood or plastic products for exterior applications in building and remodeling homes and for certain other industrial or commercial building purposes. Our products are made primarily from approximately equal amounts of recycled polyethylene plastic and waste wood fiber, which have been cleaned, sized and reprocessed utilizing our patented and proprietary technologies. Our products have been extensively tested, and are sold by leading national companies such as Lowe’s Companies, Inc. (Lowe’s) and Therma-Tru Corporation. Our products are primarily used in renovation and remodeling by consumers, homebuilders, and contractors as an exterior environmentally responsible (“Green”) building alternative for decking, railing, and trim products.

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

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Note 3: Cash Flows

In order to determine net cash provided by operating activities, net income has been adjusted by, among other things, changes in current assets and current liabilities, excluding changes in cash, current maturities of long-term debt and current notes payable. Those changes, shown as an (increase) decrease in current assets and an increase (decrease) in current liabilities, are as follows (in thousands):

	Nine months ended	
	September 30, 2015	September 30, 2014
Receivables	$872	$ (510)
Inventories	(2,685)	1,109
Prepaid expenses	197	322
Accounts payable - trade and related parties	1,982	330
Accrued liabilities	348	(89)
Change in current assets and liabilities	$714	$ 1,162
Cash paid for interest	$515	$ 453

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

	Nine months ended	
	September 30, 2015 (unaudited)	September 30, 2014 (unaudited)
Notes payable for financing manufacturing equipment	$2,322	$ -
Notes payable for financing insurance policies	$817	$ 994

Note 4: Significant Accounting Policies

Revenue Recognition Policy

The Company recognizes revenue when the title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, shipment has occurred or services have been rendered, the sales price is determinable and collectability is reasonably assured. The Company typically recognizes revenue at the time product is shipped or when segregated and billed under a bill and hold arrangement except sales to Lowe's, in which case we recognize revenue when the product is delivered to Lowe's. The following table sets forth the amount of discounts, rebates and returns for the periods indicated:

(dollars in thousands)			
Quarter ended September 30,		Nine months ended September 30,	
2015	2014	2015	2014
$811	$785	$2,804	$2,568

Estimates of expected sales discounts are calculated by applying the appropriate sales discount rate to all unpaid invoices that are eligible for the discount. The Company's sales prices are determinable given that its sales discount rates are fixed and given the predictability with which customers take sales discounts.

Shipping and Handling

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

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Inventories

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

	September 30, 2015	December 31, 2014
Raw materials	$ 6,010	$ 5,083
Work in process	2,299	1,827
Finished goods	8,692	7,406
Total inventory	$ 17,001	$ 14,316

Accounts Receivable and Factoring

Accounts receivable are uncollateralized customer obligations due under normal trade terms generally requiring payment within thirty days from the invoice date. Trade accounts are stated at the amount management expects to collect from outstanding balances. Payments of accounts receivable are allocated to the specific invoices identified on the customers' remittance advice.

Accounts receivable are carried at original invoice amounts less an estimated reserve provided for returns and discounts based on a review of historical rates of returns and expected discounts. The carrying amount of accounts receivable is reduced, if needed, by a valuation allowance that reflects management's best estimate of the amounts that will not be collected. Management individually reviews all overdue accounts receivable balances and, based on an assessment of current creditworthiness, estimates the portion, if any, of the balance that will not be collected. Management provides for probable uncollectible amounts through a charge to earnings and a credit to an allowance account based on its assessment of the current status of the individual accounts. Balances which remain outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to trade accounts receivable. Recoveries of trade receivables previously written off are recorded when received.

On February 20, 2015, the Company entered into an accounts receivable purchase agreement (Lowe's Companies, Inc. Supply Chain Financing Program) with a third party financial institution to sell selected accounts receivable from Lowe's. The Company, at its sole option, may offer to sell to the financial institution all or part of the Company's accounts receivable from Lowe's. The financial institution, upon acceptance of the offer, advances to the Company 95% of the balance due within 15 days of the invoice date with the remaining 5% being paid under agreed upon terms. AERT pays interest on advanced amounts at an agreed-upon rate (1.09% per annum at September 30, 2015). The Lowe's receivables are sold without recourse. The purchase agreement may be terminated by either party with 30-days' notice. As of September 30, 2015, the amount due from factor was $0.3 million.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP 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.

Concentration Risk

Credit Risk and Major Customers

The Company's revenues are derived principally from national and regional building products dealers and distributors. The Company extends unsecured credit to its customers. The Company's concentration in the building materials industry has the potential to impact its exposure to credit risk because changes in economic or other conditions in the construction industry may similarly affect the Company's customers.

The Company has significant customer concentration, with one customer, Lowe's, representing approximately 40% of our accounts receivable at September 30, 2015, as compared to another customer, BlueLinx, which represented approximately 80% at December 31, 2014.

For the nine months ended September 30, 2015, Lowe's represented approximately 50% of the Company's revenue compared to less than 10% for the nine months ended September 30, 2014. Our next largest customer, BlueLinx, accounted for approximately 15% of the Company's revenue for the nine months ended September 30, 2015 compared to approximately 60% for the nine months ended September 30, 2014. While, in prior years, we sold ChoiceDek® to our distributor, BlueLinx, under a bill and hold agreement, in late 2014, we commenced selling directly to Lowe's.

Cash

The Company maintains bank accounts that are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. At times, cash balances may be in excess of the FDIC limit. The Company believes no significant concentrations of risk exist with respect to its cash.

Note 5: Income Taxes

As of September 30, 2015, the Company had net operating loss (NOL) carryforwards for federal and state income tax purposes of $52.0 million that are available to reduce future taxable income. If not utilized, the NOL carryforwards will expire between 2017 and 2034.

In March 2011, H.I.G. AERT, LLC acquired a controlling interest in the Company, which resulted in a significant restriction on the utilization of the Company's NOL carryforwards. It is estimated that the utilization of future NOL carryforwards will be limited per Section 382 of the Internal Revenue Code of 1986, as amended (IRC 382), to approximately $0.8 million per year for the next 17 years. The impact of this limitation is that approximately $27.3 million in NOLs will expire before the Company can use them. Of the remaining $24.7 million in NOLs, $15.2 million is subject to the IRC 382 restriction and $10 million is available to reduce taxable income.

As there is insufficient evidence that the Company will be able to generate adequate future taxable income to enable it to realize its NOL carryforwards prior to expiration, the Company maintains a valuation allowance to recognize its deferred tax assets only to the extent of its deferred tax liabilities. The estimated annual effective income tax rate for 2015 is 0% due to the change in the valuation allowance.

Based upon a review of its income tax filing positions, the Company believes that its positions would be sustained upon an audit and does not anticipate any adjustments that would result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded. The Company recognizes interest related to income taxes as interest expense and recognizes penalties as operating expense. The Company is subject to routine audits by various taxing jurisdictions. The Company is no longer subject to income tax examinations by taxing authorities for years before 2011, except in the States of California, Colorado and Texas, for which the 2010 tax year is still subject to examination.

Note 6: Earnings per Share

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

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

In computing diluted EPS, only potential common shares that are dilutive—those that reduce EPS or increase loss per share—are included. The exercise of options or conversion of convertible securities is not assumed if the result would be antidilutive, such as when a loss from continuing operations is reported. As a result, if there is a loss from continuing operations, diluted EPS would be computed in the same manner as basic EPS is computed, even if an entity has net income after adjusting for discontinued operations or the cumulative effect of an accounting change.

The following presents the two-class method for the three and nine months ended September 30, 2015 and 2014:

BASIC AND DILUTED EARNINGS PER SHARE

(in thousands, except share and per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Net income (loss) applicable to common stock				