

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC

Form PRE 14A

June 20, 2008

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
SCHEDULE 14A
Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to §240.14a-12

Advanced Environmental Recycling Technologies, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Table of Contents

**ADVANCED ENVIRONMENTAL
RECYCLING TECHNOLOGIES, INC.
914 N Jefferson Street (72764)
Post Office Box 1237
Springdale, Arkansas 72765
(479) 756-7400**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held Thursday, July 24, 2008**

To our Stockholders:

The annual meeting of stockholders of Advanced Environmental Recycling Technologies, Inc. will be held in the John Q. Hammons Convention Center at the Embassy Suites, Rogers, Arkansas at 7:00 p.m., local time, Thursday, July 24, 2008, to consider and act upon the following matters, all as more fully described in the accompanying proxy statement which is incorporated herein by this reference:

1. To elect nine members to the nine-person board of directors to serve until the next annual meeting of stockholders and until their respective successors shall be elected and qualify.
2. To ratify the appointment of Tullius Taylor Sartain & Sartain LLP as independent public accountants of the company for the year ending December 31, 2008; and
3. In connection with an October 2007 \$10 million private placement of convertible preferred stock and warrants, to approve, for purposes of Nasdaq Rule 4350, the possible issuance of common stock equal to 20% or more of the common stock outstanding before the private placement for less than the greater of book or market value of the stock, that being a possible issuance that could be deemed under such Rule to arise as a result of conversion rights and potential anti-dilution adjustments that may occur in the future with respect to the preferred stock and warrants issued in the private placement.
4. To amend the Company's certificate of incorporation to change the voting rights of the company's Series D preferred stock to conform such voting rights to the policies of the NASDAQ Stock Market, Rule 4351, by limiting the as converted voting rights of the Series D preferred stock to a specified maximum number of votes per share.
5. To amend the Company's certificate of incorporation to authorize only holders of preferred stock affected by a proposed change to vote on matters relating only to changes to the terms of any outstanding series of preferred stock.
6. To amend the Company's certificate of incorporation to increase the authorized number of shares of Class A common stock.
7. To approve a possible reverse stock split at a ratio to be determined hereafter by the board of directors of between 1-for-2 and 1-for-5.
8. To approve the 2008 Non-Employee Director Equity Incentive Plan.
9. To approve the 2008 Key Associate and Management Equity Incentive Plan

10. To transact such other business and to consider and take action upon any and all matters that may properly come before the annual meeting or any adjournment thereof.

The board of directors has fixed the close of business on June 27, 2008, as the record date for the determination of the stockholders entitled to notice of and to vote at the annual meeting and any adjournment thereof.

Sincerely,

Marjorie S. Brooks
Secretary

June 20, 2008

Table of Contents

A proxy card and annual report of the company for the year ended December 31, 2007 are enclosed. It is important that your shares be represented whether or not you attend the meeting. Registered stockholders can vote their shares via the Internet or by using a toll-free telephone number. Instructions for using these convenient services appear on the proxy card. You can also vote your shares by marking your votes on the proxy card, signing and dating it and mailing it promptly using the envelope provided. Proxy votes are tabulated by an independent agent and reported at the annual meeting. The tabulating agent maintains the confidentiality of the proxies throughout the voting process. We hope that you can attend this meeting in person, but if you cannot do so please vote your proxy now.

TABLE OF CONTENTS

<u>SOLICITATION AND REVOCABILITY OF PROXIES</u>	1
<u>VOTING SECURITIES AND PRINCIPAL HOLDERS THEREOF</u>	1
<u>DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT</u>	3
<u>CORPORATE GOVERNANCE</u>	6
<u>AUDIT COMMITTEE REPORT</u>	7
<u>COMPENSATION COMMITTEE REPORT</u>	11
<u>DIRECTOR COMPENSATION</u>	11
<u>EXECUTIVE OFFICER COMPENSATION</u>	13
<u>SUMMARY COMPENSATION TABLE</u>	13
<u>SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE</u>	15
<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS</u>	15
<u>STOCKHOLDER RETURN PERFORMANCE GRAPH</u>	
<u>INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	16
<u>Item 1: Election of Directors</u>	16
<u>Item 2: Ratification of Appointment of Independent Registered Public Accounting Firm</u>	17
<u>Item 3: Approval of the Possible Issuance of Common Stock Equal to 20% or More of the Common Stock Outstanding Before an October 2007 Private Placement for Less Than The Greater of Book or Market Value of the Stock</u>	18
<u>Item 4: Amendment to the Certificate of Designation to Change the Voting Rights of the Company's Series D Preferred Stock to Conform Such Voting Rights to the Policies of the Nasdaq Stock Market</u>	21
<u>Item 5: To amend the Company's certificate of incorporation to authorize only holders of preferred stock affected by a proposed change to vote on matters relating only to changes to the terms of any outstanding series of preferred stock</u>	23
<u>Item 6: Amendment to the Certificate of Incorporation to Increase the Authorized Number of Shares of Class A Common Stock</u>	24
<u>Item 7: Approval of Reverse Stock Split</u>	25
<u>Item 8: Approval of 2008 Non-Employee Director Equity Incentive Plan</u>	30
<u>Item 9: Approval of 2008 Key Associate and Management Equity Plan</u>	33
<u>COST AND METHOD OF PROXY SOLICITATION</u>	37
<u>ADDITIONAL INFORMATION AVAILABLE</u>	38
<u>STOCKHOLDER PROPOSALS FOR THE ANNUAL MEETING IN 2009</u>	38
<u>OTHER MATTERS</u>	38

Table of Contents

**ADVANCED ENVIRONMENTAL
RECYCLING TECHNOLOGIES, INC.
914 N Jefferson Street (72764)
Post Office Box 1237
Springdale, Arkansas 72765
(479) 756-7400**

**Annual Meeting of Stockholders
July 24, 2008**

PROXY STATEMENT

SOLICITATION AND REVOCABILITY OF PROXIES

The enclosed proxy is solicited on behalf of the board of directors of Advanced Environmental Recycling Technologies, Inc., a Delaware corporation (the Company), for use at the annual meeting of stockholders to be held in the John Q. Hammons Convention Center at the Embassy Suites, Rogers, Arkansas, at 7:00 p.m. local time, Thursday, July 24, 2008, and at any adjournments thereof. The notice of meeting, proxy statement, and form of proxy are being mailed to stockholders on or about July 2, 2008.

A proxy may be revoked by delivering a written notice of revocation to the principal office of the Company or in person at the meeting at any time prior to the voting thereof.

VOTING SECURITIES AND PRINCIPAL HOLDERS THEREOF

At June 27, 2008, the record date, there were 46,314,250 shares of Class A common stock, 1,465,530 shares of Class B common stock and 788,182 shares of Series D preferred stock issued and outstanding. Each outstanding share of Class A common stock entitles the holder to one vote on matters submitted to the stockholders and each share of Class B common stock entitles the holder to five votes on matters submitted to the stockholders. Each outstanding share of Series D preferred stock entitles the holder to the number of votes equal to the number of shares of common stock into which such share of preferred stock could be converted (currently each such preferred share is convertible into 10 shares of Class A common stock), subject to the limitations described in Item No. 4 herein (to which all of the preferred stockholders have already agreed). As of June 27, 2008, the holders of the Class B common stock are entitled to an aggregate of 7,327,650 votes and the holders of the Series D preferred stock are entitled to an aggregate of 7,881,820 votes. The holders of record of the Class A common stock, Class B common stock and Series D preferred stock outstanding on June 27, 2008 will vote together as a single class on all matters submitted to stockholders and such other matters as may properly come before the annual meeting and any adjournments.

The enclosed form of proxy provides a method for stockholders to withhold authority to vote for any one or more nominees (See Election of Directors for the method of withholding authority to vote for directors). By withholding authority, shares will not be voted either for or against a particular matter but will be counted for quorum purposes. Abstentions and brokers' non-votes, if any, are counted for purposes of determining a quorum but will have no effect on the election of directors or other matters intended to be submitted to a vote of the stockholders.

As of June 16, 2008, the Company's executive officers and directors beneficially owned approximately 34.1% of the currently outstanding shares of Class A common stock and 93.9% of the shares of Class B common stock, and collectively beneficially owned shares representing approximately 37.5% of the votes entitled to be cast upon matters submitted at the annual meeting. As of the record date, Marjorie S. Brooks and corporations controlled by her

beneficially owned shares representing approximately 22.3% of the votes entitled to be cast and may be in a position to control the Company.

Table of Contents

The following table sets forth, as of June 16, 2008, certain information with regard to the beneficial ownership of the Company's capital stock by each beneficial owner of 5% or more of the outstanding stock, by each named executive officer and director of the Company, and by all officers and directors as a group:

Title of	Name and Address of Beneficial Owner(18)	Amount and Nature of Beneficial Ownership(2)(16)	Percent of Class	Percent of Total Voting Power(2)(17)
Class A	Marjorie S. Brooks	9,569,676(3)	20.6%	22.3%
Class B		837,588(4)	57.2%	
Class A	Joe G. Brooks	1,782,668(5)	3.8%	5.2%
Class B		284,396	19.4%	
Class A	J. Douglas Brooks	894,065(6)	1.9%	2.5%
Class B		131,051	8.9%	
Class A	Jerry B. Burkett	296,816(7)	*	*
Class B		33,311	2.3%	
Class A	Stephen W. Brooks	1,707,008(8)	3.7%	3.5%
Class B		89,311	6.1%	
Class A	Sal Miwa	168,392(9)	*	*
Class A	Jim Robason	156,310(10)	*	*
Class A	Melinda Davis	192,495(11)	*	*
Class A	Michael M. Tull	864,330(12)	1.9%	1.4%
Class A	Peter S. Lau	55,853(13)	*	*
Class A	Tim W. Kizer	22,246(14)	*	*
Class A	Edward P. Carda	22,246(14)	*	*
Class A	Jim Precht	407,700(15)	*	*
Class A	Officers and directors	16,167,805	34.1%	37.5%
Class B	as a group (fourteen persons)	1,375,657	93.9%	

- (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. Each share of Class B common stock is convertible into one share of Class A common stock.
- (2) Beneficial ownership of shares was determined in accordance with Rule 13d-3(d)(1) of the Exchange Act and included shares underlying outstanding warrants and options which the named individual had the right to acquire within sixty days (August 15, 2008) of June 16, 2008.
- (3) Includes 8,279,827 shares owned directly, 1,121,457 in trusts or corporations controlled by Mrs. Brooks, 150,000 shares issuable upon exercise of stock options, and 18,392 shares to be issued pursuant to restricted stock awards.
- (4) Includes 403,946 shares owned directly by Mrs. Brooks and 433,642 shares owned by two corporations controlled by Mrs. Brooks. (Razorback Farms, Inc. is the record owner of 312,320 shares and Southern Mineral

and Fibers, Inc. 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 Mrs. Brooks, including Joe G. Brooks, Stephen W. Brooks and J. Douglas Brooks, as to which she disclaims a beneficial interest.

- (5) Includes 1,739,963 shares owned directly, 4,500 shares owned as custodian for Joe G. Brooks minor child, and 38,205 shares owned as custodian for Brooks Children's Trust.
- (6) Includes 809,324 shares owned directly and 84,741 shares owned indirectly.
- (7) Includes 116,424 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, 150,000 shares issuable upon exercise of stock options, and 18,392 shares to be issued pursuant to restricted stock awards.
- (8) Includes shares owned directly.

Table of Contents

- (9) Includes 150,000 shares issuable upon exercise of stock options and 18,392 shares to be issued pursuant to restricted stock awards.
- (10) Includes 112,918 shares owned directly, 25,000 shares issuable upon exercise of stock options, and 18,392 shares to be issued pursuant to restricted stock awards.
- (11) Represents 32,436 shares owned directly, 66,667 shares in a trust controlled by Ms. Davis, 75,000 shares issuable upon exercise of stock options, and 18,392 shares to be issued pursuant to restricted stock awards.
- (12) Includes 745,938 shares owned directly, 100,000 shares issuable upon exercise of stock options, and 18,392 shares to be issued pursuant to restricted stock awards.
- (13) Includes 2,500 shares owned directly, 25,450 shares owned indirectly through corporations, 25,000 shares issuable upon exercise of stock options, and 2,903 shares to be issued pursuant to restricted stock awards.
- (14) Includes 5,256 shares owned directly and 16,990 shares to be issued pursuant to restricted stock awards.
- (15) Includes 7,700 shares owned directly and 400,000 shares issuable upon exercise of stock options.
- (16) Class A common stock beneficial ownership was calculated by dividing the beneficial ownership of each individual by the sum of: (i) the total shares of Class A common stock outstanding at June 16, 2008, and (ii) the total shares underlying outstanding warrants and options which the named individual had the right to acquire within 60 days (August 15, 2008) of June 16, 2008. Class B common stock beneficial ownership is calculated based on 1,465,530 shares outstanding on June 16, 2008.
- (17) Calculated by dividing the voting rights of the beneficial ownership of each individual by the sum of: (i) the total votes available to be cast on June 16, 2008, and (ii) the total shares underlying outstanding warrants and options which the named individual had the right to acquire within 60 days (August 15, 2008) of June 16, 2008.
- (18) Each of the following listed stockholders is either an officer or director of the Company and in each case may be addressed in care of the Company at P.O. Box 1237, Springdale, AR 72765.

DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

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

Name	Age	Position
Joe G. Brooks	52	Chairman of the board of directors, chief executive officer
Stephen W. Brooks	51	Chief operating officer and director
Marjorie S. Brooks	72	Secretary, treasurer and director
Timothy D. Morrison	49	President
J. Douglas Brooks	48	Senior vice-president international sales and product development
Alford Drinkwater	56	Senior vice president development and governmental affairs

Jim Precht	62	Senior vice-president sales and marketing
Eric E. Barnes	34	Controller and chief accounting officer
Jerry B. Burkett	51	Director
Edward P. Carda	67	Director
Melinda Davis	65	Director
Tim W. Kizer	42	Director
Peter S. Lau	54	Director
Jim Robason	70	Director
Michael M. Tull	53	Director
Sal Miwa	51	Director

The Company's board of directors elected **Joe G. Brooks** as its chairman and the Company's co-chief executive officer in December 1998. In addition, he served as president from February 2000 until February 2008. In

Table of Contents

July 2005, Mr. Brooks became sole chief executive officer. Mr. Brooks has served as president or in other executive office capacities and has been a director since the Company's inception in December 1988, including service as chairman and CEO from inception until August 1993. He was a member of Clean Texas 2000, appointed by then Governor George W. Bush in 1995. Mr. Brooks is a listed inventor on 13 of the Company's patents with additional patents pending, and is a founder of AERT.

The Company's board of directors elected **Stephen W. Brooks** as co-chief executive officer in December 1998 in which position he served until July 2005 when he became vice chairman and chief operating officer. Mr. Brooks has been a director since January 1996. Mr. Brooks has served as CEO and chairman of the board of Razorback Farms, Inc. from January 1996 to the present. Razorback Farms is a Springdale, Arkansas based firm that specializes in vegetables processing. Mr. Brooks also serves on the board of the Ozark Food Processors Association.

Marjorie S. Brooks has been secretary, treasurer and a director since the Company's inception in December 1988. Mrs. Brooks has served as secretary and treasurer of Brooks Investment Co., a holding company for the Brooks' family investments, for more than thirty years.

Melinda Davis has served on the board of directors since July 2001. From December 2000 to the present, Ms. Davis has provided professional consulting services in the areas of financial management and cost accounting for manufacturing operations. Ms. Davis retired as senior vice-president and treasurer from Allen Canning Co. in December 2000, after serving for 39 years in various accounting and financial management positions.

J. Douglas Brooks has served as executive vice-president from inception to September 2003, has been in charge of raw material sourcing and strategic relationships since 1998, and has been a senior vice president since September 2003. Mr. Brooks was vice-president of plastics from 1995 through 1998, was previously project manager for AERT's polyethylene recycling program with The Dow Chemical Company, and is a joint inventor on several of AERT's process patents for recycling polyethylene film for composites.

Timothy D. Morrison joined AERT as President in February 2008. Mr. Morrison came to AERT with a background in polymer engineering as well as experience in turnaround management. He began his career with Dow Chemical in the hydrocarbons and polyethylene group where he held both operations and business positions. He led the Promix Joint Venture with Dow, Texaco and Enterprise Products before moving to Harris Chemical in 1992 as an equity partner where he led the turnaround of operations, customer service, IT, purchasing, and logistics for the leveraged buyout group. In 2000, Mr. Morrison joined Cyctec's engineered products composite business, managing the composites and adhesives business. He brings experience in successfully servicing the needs and requirements of big box retailers from Valspar where he served most recently as manager for Valspar's Texas Division. Tim comes to AERT with a BS in Chemical Engineering from the University of Alabama, an MBA from the University of Southern California, and training in both Lean Manufacturing and Six Sigma.

Alford Drinkwater has served as senior vice president of logistics, laboratories, and plastic operations since September 2003. Prior to joining the Company in May 2000, Mr. Drinkwater had been the Assistant Director for the Established Industries Division of the Arkansas Department of Economic Development and was on the Advocacy Team from November 1988 until January 2000. From September 1986 until July 1988, he owned and operated Town and Country Waste Services, Inc. a waste services company engaging in the development of waste recycling, energy recovery, and disposal systems. From April 1981 until January 1987, Mr. Drinkwater was the Resource Recovery Manager for Metropolitan Trust Company, and was primarily involved in waste-to-energy systems development. From July 1974 until April 1981, Mr. Drinkwater worked for the State of Arkansas as Assistant to the Chief of the Solid Waste Control Division of the Arkansas Department of Pollution Control & Ecology and as the Manager of the Biomass and Resource Recovery Program of the Arkansas Department of Energy.

Jim Precht served as executive vice-president of sales and marketing for the Company since February 2001, and as senior vice president since September 2003. Mr. Precht was formerly general manager of Weyerhaeuser Building Materials Pittsburgh Customer Service Center with 32-years of industry experience.

Eric E. Barnes, who the board of directors appointed as chief accounting officer in September 2005, also heads up the AERT accounting and control team. Mr. Barnes joined AERT's accounting department in November 1997 after graduating from the University of Arkansas with a BS in Accounting and an MA in Economics. He was named AERT's controller in January 2000. Mr. Barnes was also named acting principal financial officer in April 2008 upon

Table of Contents

Mr. Robert Thayer's resignation and until a permanent replacement for Mr. Thayer as Chief Financial Officer is identified. Mr. Barnes is a Certified Public Accountant.

Jerry B. Burkett has served on the board of directors of the Company since May 1993. Mr. Burkett has been a rice and grain farmer since 1979 and has been a principal in other closely held businesses. He is the past president of the Arkansas County Farm Bureau. In April 2002, Mr. Burkett was elected to serve as a director of the Ag Heritage Farm Credit Services board.

Edward P. Carda was elected to the board of directors in July 2005. Mr. Carda began his 37-year business career with Weyerhaeuser Company in June 1967, ending with his retirement in December 2003. While at Weyerhaeuser, he served in various management positions, including statutory reporting, heading large accounting departments, interacting with external and internal auditors and all types of management. Mr. Carda spent the last 10 years of his career as the business controller for the distribution business of Weyerhaeuser. While in this capacity, he received many awards for his performance for profit and working capital improvement initiatives. Mr. Carda attended the University of Montana and graduated with a degree in accounting. He has served for 25 years on the board of directors of the Woodstone Credit Union in Federal Way, Washington and is currently its Vice Chairman. He also serves on the credit union's audit committee.

Tim W. Kizer was elected to the board of directors in July 2005. Since December 2004, Mr. Kizer has served as president and partner of Bentonville Global Associates, a global consultancy firm specializing in collaborative commerce. Mr. Kizer is executive director of the *Doing Business in Bentonville Series* seminar level program series in Bentonville Arkansas. From April 2001 to December 2004, Mr. Kizer was director of the Center for Management and Executive Development and the Donald W. Reynolds Center for Enterprise Development, Sam M. Walton College of Business, University of Arkansas. From January 2000 to April 2001, Mr. Kizer was managing director of Information Technology Research Center, Sam M. Walton College of Business, University of Arkansas. Mr. Kizer was a business and industry specialist for the Division of Continuing Education at the University of Arkansas from October 1996 until January 2000. He has a BA from the University of Louisville and is a member of the Board of Advisors of RFID Global Solution in Bentonville, Arkansas.

Peter S. Lau has served on the board of directors since July 2007. Mr. Lau is a co-founder and owner of Greenstone Holdings, a boutique investment banking firm in New York City founded in 2001 (not affiliated with the entity of the same name referred to with respect to Mr. Miwa). Previously, he was Senior Managing Director of Corporate Finance for American Frontier, and Managing Director of Corporate Finance at Ridgewood Capital. Mr. Lau started his career as a CPA with Deloitte Touche, and was later employed by Squibb Corporation. Mr. Lau holds a Bachelor of Science in Business Administration and an MS in Accounting from the University of Hartford.

Sal Miwa has been an outside director of the Company since January 1994. He served as chairman of the board between December 1995 and December 1998, and as vice chairman from December 1998 through July 2005. From January 2005 to present, Mr. Miwa has been chairman of Greenstone Holdings, Inc. (OTC: GSHG), a chemical technology company located in New York City primarily serving the building and construction industry (not affiliated with the entity of the same name referred to with respect to Mr. Lau). From July 2004 to December 2005, he was CEO of Greenstone Inc. of Delaware, a predecessor of Greenstone Holdings, Inc. From April 2000 to June 2004, he was COO and director of RealRead Inc., an online document service company. For more than 20 years Mr. Miwa has been engaged in various international businesses and serves on boards of several closely held family businesses around the world. He received his master's degree in aerospace engineering from the Massachusetts Institute of Technology in 1981.

Jim Robason has served on the board of directors since July 2003. Since January 2005, Mr. Robason has been a consultant to and supervisor of the Company's plant operations on an interim basis. Mr. Robason joined Allen Canning

Co. in 1967. Mr. Robason served as senior vice-president-operations of Allen Canning Co. from 1974 until his retirement in 2002. As senior vice-president of operations with Allen Canning Co., he was responsible for the operation of twelve plants with plant managers and raw product procurement managers, as well as special projects engineering, reporting to him. He has a vast amount of knowledge in all phases of manufacturing including infrastructure, building, equipment, and engineering; with a focus on the full production arena from product procurement through the production process. Mr. Robason is a graduate of West Texas State University. He has served on Allen Canning's executive committee and profit sharing/retirement plan committee in addition to his operations responsibilities.

Table of Contents

Michael M. Tull has served on the board of directors of the Company since December 1998. Mr. Tull has served since 1990 as the president and majority owner of Tull Sales Corporation, a manufacturer's representative company, which professionally represents eight manufacturing companies and is responsible for the sales and marketing of those companies' window and door related components in the southeastern United States. Mr. Tull serves on boards of several closely held family businesses. Additionally, he is a board of director member of Greenstone, Inc. and the National Wild Turkey Federation, which is one of the largest North American conservation organizations.

Joe G. Brooks, Stephen W. Brooks, and J. Douglas Brooks are brothers and are sons of Marjorie S. Brooks, the Company's largest stockholder and a director. There are no other familial relationships between the current directors and executive officers.

Each of the Company's directors has 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.

CORPORATE GOVERNANCE

Independence of Directors

The board of directors has determined that Jerry B. Burkett, Edward P. Carda, Tim W. Kizer, Peter S. Lau, and Sal Miwa are independent under the NASDAQ Stock Market's (NASDAQ) corporate governance listing standards, and that Joe G. Brooks, chairman and CEO, Stephen W. Brooks, chief operating officer, Michael M. Tull and Jim Robason are not independent under such listing standards.

During fiscal 2007, the Company held eight executive sessions of the board of directors in which only independent members of the board were present. The chairpersons of the audit committee, compensation committee and nominating and corporate governance committee each presided over the meetings on a rotating basis.

The Company encourages, but does not require, directors to attend annual meetings of stockholders. All members of the board attended the Company's 2007 stockholder meeting.

Board Meeting and Certain Committees Reports and Meetings

During the Company's fiscal year ended December 31, 2007, the board of directors held eight meetings. All directors attended 75% or more of the total number of meetings of the board of directors and its committees on which he or she served.

From January 1, 2007 through July 19, 2007, the audit committee of the board of directors consisted of four independent directors under NASDAQ's director and audit committee independence standards: Jerry B. Burkett, Melinda Davis (chairperson), Sal Miwa, and Edward P. Carda. On July 19, 2007, the Board appointed Melinda Davis, Ed Carda (chairperson), Jerry Burkett, and Peter Lau. The composition of the audit committee has not changed since July 19, 2007. The audit committee is directly responsible for the engagement of the Company's independent accountants and is 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 audit committee met six times in 2007. Melinda Davis serves as the financial expert on the audit committee. Following the annual meeting, when Ms. Davis retires from the board of directors, it is anticipated that Mr. Carda will serve as the financial expert.

From January 1, 2007 through July 19, 2007, the compensation committee consisted of Samuel L. Milbank (chairperson), Sal Miwa and Edward P. Carda. On July 19, 2007, the Board appointed Ed Carda (chairperson), Sal

Miwa, Tim W. Kizer, and Jim Robason to the committee. The composition of the compensation committee has not changed since July 19, 2007. The compensation committee establishes and administers the Company's compensation plans on behalf of the board of directors and makes recommendations to the board of directors as to stock options, restricted stock awards or other awards granted thereunder and other compensation matters. The compensation committee met six times in 2007.

From January 1, 2007 through July 19, 2007, the nominating and corporate governance committee consisted of Jerry B. Burkett (chairperson), Melinda Davis, and Tim W. Kizer. On July 19, 2007, the Board appointed Sal Miwa (chairperson), Melinda Davis, Jerry Burkett, and Ed Carda to the committee. The composition of the nominating

Table of Contents

and corporate governance committee has not changed since July 19, 2007. The nominating and corporate governance committee evaluates the efforts of AERT and its board of directors to maintain effective corporate governance practices and identifies candidates for election to the board of directors. The nominating and corporate governance committee met four times in 2007.

The nominating and corporate governance committee believes that candidates for director should have certain minimum qualifications, including being able to read and understand financial statements and having the highest personal integrity and ethics. The committee also considers such factors as relevant expertise and experience, ability to devote sufficient time to the affairs of the Company, demonstrated excellence in his or her field, the ability to exercise sound business judgment and the commitment to rigorously represent the long-term interests of the Company's stockholders. Candidates for director will be reviewed in the context of the current composition of the board, the operating requirements of the Company and the long-term interests of stockholders.

The nominating and corporate governance committee does not have a formal process for identifying and evaluating nominees for directors. Instead, it uses its network of contacts to identify potential candidates. The committee will conduct any appropriate and necessary inquiries into the backgrounds and qualifications of possible candidates after considering the function and needs of the board. The committee will meet to discuss and consider such candidates qualifications and then select a nominee for recommendation to the board by majority vote.

Although the nominating and corporate governance committee has not established procedures for considering nominees recommended by stockholders, the committee will consider director candidates recommended by stockholders, and those candidates will receive substantially the same consideration that candidates recommended by the nominating and corporate governance committee receive. Stockholders wishing to recommend director candidates for consideration by the committee may do so in writing to the corporate secretary by February 28, 2009, at least 120 days in advance of the date corresponding to the mailing of proxy materials for this annual meeting, giving the recommended nominee's name, biographical data, and qualifications, accompanied by the written consent of the recommended nominee.

The charters of the audit, compensation, and nominating and corporate governance committees are available on the corporate website at www.aertinc.com. The Company has implemented a Corporate Hotline through which the audit committee, the board of directors, and the corporate compliance officer may be contacted, as appropriate. This service and number is available on our corporate website.

AUDIT COMMITTEE REPORT

The following report of the audit committee for fiscal year 2007 does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Company filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates this report by reference therein.

The audit committee of the Company is composed of four non-employee directors, and each member of the committee is independent in accordance with the policy of the National Association of Security Dealers applicable to NASDAQ listed companies. The committee operates under a written charter adopted by the board of directors.

Management is responsible for the Company's internal controls and the financial reporting process. The independent auditors are responsible for performing an independent audit of the Company's financial statements in accordance with generally accepted auditing standards and to issue a report thereon. The committee's responsibility is to engage independent public accountants for the Company and to monitor and oversee the Company's financial reporting process and report its findings to the board of directors.

The committee fulfills its responsibilities through periodic meetings with management and independent auditors. The committee reviewed and discussed with management and independent auditors the audited financial statements in the Company's annual report on Form 10-K for the year ended December 31, 2007. The committee also discussed with the independent auditors matters required to be discussed by Statement on Auditing Standards No. 61. In addition, the committee has received and reviewed the written disclosures and the letter from the

Table of Contents

independent auditors required by Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees, and has discussed with the auditors the auditor's independence.

On the basis of these reviews and discussions, the audit committee recommended to the board of directors that the board approve the inclusion of the Company's audited financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, for filing with the Securities and Exchange Commission (SEC).

The audit committee has also considered whether the provision of non-audit services by the independent registered public accounting firm, Tullius Taylor Sartain & Sartain LLP (TTS&S), is compatible with maintaining auditor independence. TTS&S performed tax preparation services for the Company during 2007. No other non-audit related services were provided by TTS&S during 2007.

Submitted by the audit committee,

Jerry B. Burkett

Peter S. Lau

Edward P. Carda, Chairperson

Melinda Davis

COMPENSATION DISCUSSION AND ANALYSIS

Overview of Compensation Program

Our executive compensation program is designed to achieve our goal of attracting, developing and retaining business leaders who can drive financial and strategic growth objectives that are intended to maximize long-term stockholder value. Compensation levels are set to reflect competitive market practices, as well as company and individual performance. The Compensation Committee of the Board of Directors (the Committee) has established the following guiding principles for our executive compensation programs:

Competitiveness All components of compensation should be set competitively as compared against appropriate peer companies so that we can continue to attract, retain and motivate high performing executive talent.

Pay for Performance All components of compensation should be tied to the performance of the individual executive officer, his or her specific business unit or function, and AERT overall.

Accountability for Short- and Long-Term Performance Annual performance bonuses and long-term incentives should reward an appropriate balance of short-and long-term financial and strategic business results, with an emphasis on managing the business for the long-term.

Alignment to Stockholders' Interests Long-term incentives should align decision making with the interests of our stockholders.

Compensation Philosophy and Objectives

Our executive compensation program is designed to:

Attract, motivate and retain executive officers who can make significant contributions to our long-term success;

Align the interests of executive officers with those of stockholders; and

Place a significant portion of an executive officer's total compensation at risk by tying it to our financial performance.

Role of Executive Officers in Compensation Decisions

To assist them in making compensation decisions, the Committee reviews compensation tally sheets, prepared by management, which present comprehensive data on the total compensation and benefits package for each of our executive officers. These tally sheets include all obligations for present and projected future compensation, as well as analyses for hypothetical terminations and retirements to consider our obligations under such circumstances.

Table of Contents

Additionally, the Committee partially relies on recommendations by the CEO regarding compensation of the other executive officers and key management employees.

Setting Executive Compensation

The Committee strives to establish and periodically review AERT's compensation philosophy and the adequacy of compensation plans and programs for directors, executive officers and other AERT employees and make recommendations to the Board of Directors regarding:

Compensation arrangements and incentive goals for executive officers and administration of the compensation plans and recommendations to the Board of Directors with respect thereto;

The performance of the executive officers and incentive compensation awards and adjustment of compensation arrangements as appropriate based upon performance;

Management development and succession plans and activities; and

The report on executive compensation for inclusion in AERT's annual proxy statement in accordance with Securities Exchange Commission rules and regulations.

The primary components of our executive compensation programs are: base salary, discretionary awards, and long-term incentive awards.

Base Salary

Base salaries are generally targeted at the middle of the competitive marketplace (the median).

The market rate for an executive position is determined through an assessment by our human resources personnel under the guidance and supervision of the Committee. This assessment considers relevant industry salary practices, the position's complexity, and level of responsibility, its importance to AERT in relation to other executive positions, and the competitiveness of an executive's total compensation.

Subject to the Committee's approval, the level of an executive officer's base pay is determined on the basis of:

Relevant comparative compensation data; and

The Chief Executive Officer's assessment (except with respect to himself) of the executive's performance, experience, demonstrated leadership, job knowledge and management skills.

Discretionary Awards

The Committee may, at its discretion, authorize periodic cash awards to executives. Discretionary awards are designed to give the Committee the flexibility to provide incentives that are comparable to those found in the marketplace in which we compete for executive talent. In determining the extent and nature of discretionary awards, the Committee considers our cash flow, net income, progress toward short-term and long-term business objectives, and other competitive compensation programs.

When considering discretionary awards, the Committee identifies the employees who are eligible to participate and computes and certifies the size of the discretionary pool based on financial information supplied by our executive

officers. The award made to each eligible participant is based on the opportunity level assigned to the participant and an assessment of his or her performance and the performance of their business unit versus corporate objectives.

Long-Term Incentive Awards

Long term executive incentives are designed to promote the interests of AERT and its stockholders by attracting and retaining eligible directors, executives and other key employees.

The Committee has the authority to determine the participants to whom awards shall be granted. The awards under our prior plans could be made in the form of stock options, restricted stock units, performance awards and

Table of Contents

other stock-based awards. Consistent with the views of the Board of Directors and the Committee that the interests of employees and directors are more likely to be aligned with stockholders to the extent that such employees and directors are stockholders of AERT, we have determined for the foreseeable future to provide incentive equity compensation in the form of restricted stock unit awards rather than options or other forms of equity compensation. The 2005 Key Associate and Management Equity Incentive Plan and the 2005 Non-Employee Director Equity Incentive Plan reflected this shift in compensation policy, as do the proposed 2008 plans submitted for approval at the annual meeting.

The Committee has reviewed and approved a compensation plan for our management and executives that is designed to reward focus on increasing throughputs, reducing costs, and increasing efficiencies. The equity incentive plans, which are administered by the Committee, gives us flexibility to provide incentives that are comparable to those found in the marketplace in which we compete for management and associate talent. In determining the extent and nature of awards, the Committee considers our cash flow, net income, progress toward short-term and long-term business objectives, and other competitive compensation programs.

2007 Executive Compensation Components

For the fiscal year ended December 31, 2007, compensation decisions focused on the key elements of the total direct compensation program for executive officers, which included base pay, discretionary incentive awards, and long-term incentives. Elements reviewed as part of the long-term incentives to executive officers included type and level of award distribution.

Chief Executive Officer Compensation

In determining CEO and other named executive officer compensation, the Committee considered:

AERT's financial performance and peer group compensation data; and

In the case of all executive officers, leadership, decision-making skills, experience and knowledge; and in addition, for the CEO, communication with the Board of Directors and strategic recommendations, as well as AERT's positioning for future performance.

The Committee considered many factors and did not place any particular relative weight on one over another, but our financial performance is generally given the most weight.

The Committee's recommendations regarding CEO compensation and other related matters are reported to and approved by the Board of Directors. In the case of other named executive officers, the CEO makes recommendations regarding compensation to the Committee, and the Committee formulates its recommendations and brings them to the Board of Directors for approval.

For fiscal year ended December 31, 2007, the Committee did not grant any discretionary bonuses or long-term incentive awards, including to the CEO.

Tax and Accounting Implications

Deductibility of Compensation