ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC
Form S-1
February 09, 2009

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As filed with the Securities and Exchange Commission on February 9, 2009

REGISTRATION STATEMENT NO. 333-

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

FORM S-1
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

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)	(IRS Employer Identification Number)

914 N. JEFFERSON STREET, PO BOX 1237, SPRINGDALE, AR 72765
(479) 756-7400
(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

JOE G. BROOKS, CHIEF EXECUTIVE OFFICER
ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.
914 N. JEFFERSON STREET, PO BOX 1237, SPRINGDALE, AR 72765
(479) 756-7400
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies of all communications to:

J. Patrick Ryan Akin, Gump, Strauss, Hauer & Feld, L.L.P. 300 Convent Street, Suite 1500 San Antonio, Texas 78205 (210) 281-7000 (210) 224-2035 (fax)	Patrice H. Kloss Oppenheimer Wolff & Donnelly LLP Plaza VII, Suite 3300 45 South Seventh Street Minneapolis, MN 55402 (612) 607-7000 (612) 607-7100 (fax)

Approximate date of proposed sale to the public: From time to time after the effective date of this Registration Statement, as determined by market conditions.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box: þ

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

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

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Unit	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Renewable Unsecured Subordinated Notes	$50,000,000	(1)	$50,000,000	$1,965

(1) The Renewable Unsecured Subordinated Notes will be issued in denominations selected by the purchasers in any amount equal to or exceeding $1,000.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

PROSPECTUS

SUBJECT TO COMPLETION, ____________________

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

$50,000,000

Six Month Renewable Unsecured Subordinated Notes

One, Two, Three, Four, Five and Ten Year Renewable Unsecured Subordinated Notes

We are offering an aggregate principal amount of up to $50 million of our renewable unsecured subordinated notes. We may offer the notes from time to time with maturities ranging from six months to ten years. Depending on our capital needs, however, notes with certain terms may not always be available. We will establish interest rates on the securities offered in this prospectus from time to time in prospectus supplements. Once you purchase a note, changes in interest rates will not affect the interest rate of your note up to its maturity. The notes are unsecured obligations and your right to payment is subordinated in right of payment to all of our existing or future senior, secured, unsecured and subordinate indebtedness and other of our financial obligations. Upon maturity, the notes will be automatically renewed for the same term as your maturing note at an interest rate that we are offering at that time to other investors with similar aggregate note portfolios for notes of the same term, unless we or you elect not to have them renewed. If notes of the same term are not then being offered, the interest rate upon renewal will be the rate specified by us on or before maturity, or the rate of the existing note if no such rate is specified. The interest rate on your renewed note may be different than the interest rate on your original note.

After giving you thirty days advance notice, we may redeem all or a portion of the notes for their original principal amount plus accrued but unpaid interest. You also may request us to repurchase your notes prior to maturity; however, unless the request is due to your death or total permanent disability, we may, in our sole discretion, decline to repurchase your notes, and will, if we do elect to repurchase your notes, charge you a penalty of up to six months of interest. Our obligation to repurchase notes prior to maturity for any reason in a single calendar quarter is limited to the greater of $1 million or 2% of the aggregate principal amount of all notes outstanding at the end of the previous quarter.

The notes will be marketed and sold through Sumner Harrington Ltd., which is acting as our selling agent for the notes. The notes will not be listed on any securities exchange or quoted on Nasdaq or any over-the-counter market. Sumner Harrington Ltd. does not intend to make a market in the notes and we do not anticipate that a market in the notes will develop. There will be significant restrictions on your ability to transfer or resell the notes. Sumner Harrington Ltd. also will act as our servicing agent in connection with our ongoing administrative responsibilities for the notes. We have not requested a rating for the notes; however, third parties may independently rate them.

THE NOTES ARE NOT CERTIFICATES OF DEPOSIT OR SIMILAR OBLIGATIONS OF, AND ARE NOT GUARANTEED OR INSURED BY, ANY DEPOSITORY INSTITUTION, THE FEDERAL DEPOSIT INSURANCE CORPORATION, THE SECURITIES INVESTOR PROTECTION CORPORATION OR ANY OTHER GOVERNMENTAL OR PRIVATE FUND OR ENTITY.

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INVESTING IN THE NOTES INVOLVES RISKS, WHICH ARE DESCRIBED IN RISK FACTORS BEGINNING ON PAGE 7 OF THIS PROSPECTUS.

THIS PROSPECTUS MAY BE USED TO OFFER AND SELL SECURITIES ONLY IF ACCOMPANIED BY THE PROSPECTUS SUPPLEMENT THAT DESCRIBES THE INTEREST RATE AND MATURITY FOR THOSE SECURITIES.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Note	Total
Public Offering Price	100.00%	100.00%
Selling agent commissions	3.00%	3.00%
Proceeds to AERT, before expenses	97.00%	97.00%

The selling agent will not receive the entire 3.00% gross commission on notes with terms of less than two years unless the notes are successively renewed for a total term of two years or more. See Plan of Distribution for a description of additional compensation payable to the selling agent and its affiliates in connection with services rendered in offering and selling the notes, serving as servicing agent and providing and managing the advertising and marketing functions related to the sale of the notes. There will be no underwriting discount.

Sumner Harrington Ltd. is not required to sell any specific number or dollar amount of notes but will use its best efforts to sell the notes offered.

We will issue the notes in book-entry or uncertificated form. Subject to certain limited exceptions, you will not receive a certificated security or a negotiable instrument that evidences your notes. Sumner Harrington Ltd. will deliver written confirmations to purchasers of the notes. U.S. Bank National Association will act as trustee for the notes.

SUMNER HARRINGTON LTD.

The date of this Prospectus is ____________________, 2009.

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PROSPECTUS SUMMARY

This summary highlights selected information from this prospectus and may not contain all the information that may be important to you. Therefore, you should also read the more detailed information set forth in this prospectus, our financial statements and the other information that is incorporated by reference into this prospectus before making a decision to invest in the notes. Trademarks used in this prospectus are the property of their respective owners.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

Advanced Environmental Recycling Technologies, Inc. (AERT), founded in 1988, recycles polyethylene plastic and develops, manufactures, and markets composite building materials that are used in place of traditional wood or plastic products for exterior applications in building and remodeling homes and for certain other industrial or commercial building purposes. Our decking and trim products are sold primarily under the trade names ChoiceDek and MoistureShield and offer an attractive wood grain appearance in multiple styles and colors. Our products are made primarily from approximately equal amounts of waste wood fibers, which have been cleaned, sized and reprocessed, and recycled polyethylene plastics, which have been cleaned, processed, and reformulated utilizing our patented and proprietary technologies. Our products have been extensively tested, and are sold by leading U.S. companies such as Lowe s Companies, Inc. (Lowe s) and Therma-Tru Corporation. Since inception in 1988, we have sold over $620 million of products into the North American marketplace. Our products are primarily used in renovation and remodeling by consumers, homebuilders, and contractors as a low maintenance, exterior green building alternative for decking, railing, and trim products. The majority of our business is in decking, railing accessories, and trim products through ChoiceDek for the home improvement warehouse (HIW) market, which is sold by Lowe s Home Improvement Warehouses. Our door component segment comprises less then 10% of our business. We also began field testing a new line of fencing in 2007 and intend to launch a new line of LifeCycle Ecotile flooring in 2009.

The ChoiceDek product has been carried nationwide by Lowe s Home Improvement Warehouses since 2002 and has been distributed by Weyerhaeuser Company (Weyerhaeuser). In October 2008, we signed a supply agreement with Lowe s for distribution of ChoiceDek® brand decking materials and other products and accessories by direct sales to Lowe s. However, we will only begin selling pursuant to the new Lowe s agreement upon termination of the Weyerhaeuser agreement and sales arrangement, which termination is contingent upon our purchasing all existing saleable ChoiceDek inventory from Weyerhaeuser and establishing an adequate line of credit to finance Lowe s inventory requirements. We agreed during the term of the new Lowe s agreement to distribute and sell ChoiceDek® brand decking and other ChoiceDek products (and other products having the same or substantially the same formulation and design) only to Lowe s in the HIW market; however, this exclusive sale commitment excludes and does not restrict sales of our MoistureShield® decking materials and other non-ChoiceDek® products. Lowe s reserves the right to manufacture, distribute and sell products of the same type or class as the ChoiceDek products and the parties may consult and agree from time to time to add or delete products to be subject to such exclusivity provisions. We agreed to provide customary support services in connection with the arrangement and to treat Lowe s as a most favored customer as it relates to the ChoiceDek exclusive products. The new Lowe s agreement does not provide for minimum product purchase commitments. The initial term of the agreement is two years from January 1, 2009 with automatic one year renewals unless either party elects in advance not to renew, although the agreement may be terminated earlier by either party in the event of a default by the other party. In addition, if during the term of the new Lowe s agreement we propose to sell or transfer any material portion of the AERT business that provides Lowe s the ChoiceDek products, Lowe s is entitled to a 60-day right of first refusal to acquire such business. Lowe s may terminate the Lowe s agreement if it does not exercise such right of first refusal.

In 2006, we launched our MoistureShield decking line into the non-HIW market targeted towards professional contractors and large deck builders. In 2007, we expanded MoistureShield distribution via a growing network of regional distributors. In the fall of 2007, we retained a national advertising and marketing agency to help us diversify our customer base and expand sales and distribution and to initiate a nationwide green building brand awareness campaign for our MoistureShield product line. It is our plan to seek additional sales for our decking products through a combination of increased and expanded distribution throughout North America, conversion of builders and

contractors from other products, and international sales via export. In 2007, we commenced exporting to a new distributor in the Peoples Republic of China and received the Award for Innovation at the Beijing Builder s Show in China. We have also recently shipped a

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limited amount of product to other countries, and are seeking to increase our international shipments in 2009. Additionally, we plan to increase our green building and sustainability marketing focus in 2009.

We recently entered into a financing agreement with an investment banking firm, Greenstone Holdings, for the establishment of a technology transfer and licensing entity, AERT Asia Ltd., to be based in Hong Kong. Greenstone is an affiliate of our director, Peter Lau. AERT Asia will be owned 80% by AERT and 20% by other investors, and will license AERT technologies and manufacturing rights for royalties, as well as establish joint ventures for plastic recycling and reformulation and wood plastic composite manufacturing in China and throughout Asia and Eastern Europe. AERT Asia has entered into a non-binding letter of intent with a mainland China manufacturing group for the establishment of a joint venture wood-plastic composite manufacturer that will produce high quality composite materials for distribution and sales in China, Asia and Eastern European markets. AERT will provide technology, technical and manufacturing support along with licensing under its International Code Council certification for products, and Greenstone will arrange financing and obtain all necessary permits and requirements from Chinese authorities. Formal documentation is pending, and it is anticipated that limited manufacturing of initial products in the Chinese market will begin in 2009.

We currently have 12 patents and six patents pending in the U.S. Our patents cover plastic recycling processes, methods, and apparatus or specially designed equipment as well as the composite product that we manufacture. The composite product patent was issued in 1998 and expires in 2015. This patent covers the unique properties, formulation and processing parameters of our encapsulated wood/polyethylene plastic composite building material.

We have five patents expiring in 2010 related to early stage plastic recycling processes and initial apparatus or equipment. We believe the plastic waste stream has diversified and has become more complex and difficult since that time. We have subsequently updated and continued to refine our recycling processes, procedures, and technologies since that time, many of which improvements are covered in later issued patents or pending patent applications. We have taken additional measures to protect our intellectual property, including the restriction of access to our facilities, hiring of licensed security personnel, maintaining a policy of non-disclosure among our associates, and limiting and restricting access to our laboratories and technical areas.

We currently operate a composite extrusion facility in Springdale, Arkansas, and a plastic recycling, warehouse and reload complex in Lowell, Arkansas. We also own a second composite extrusion facility in Springdale that has been temporarily idled during the current recession and downturn in building activity until demand for our products increases. We have downsized operations, subleased facilities, idled excess manufacturing capacity, and reduced headcount as a result of the economic downturn in the U.S., including shutting down a composite extrusion facility in Junction, Texas. In the fourth quarter of 2008, we recorded an impairment charge for our fixed assets at our Junction facility of approximately $3.4 million. In September 2008, we began construction of an additional plastics recycling facility in Watts, Oklahoma. This facility is projected to come online in the second quarter of 2009, and is intended to recycle lower grades of polyethylene plastic scrap that are currently not being recycled in order to reduce our costs of recycled plastics and value added compounds and to also allow for potential sales of recycled plastics to third parties.

On January 9, 2009, we received Federal court approval of a class action settlement that provides a framework to resolve claims arising from allegations of excessive surface staining from mold and mildew on our ChoiceDek decks (see *Risk Factors Related to Operating Our Business-We have Recently been Sued by Plaintiffs Alleging Defects in Our Decking Products*).

Our corporate offices are located at 914 N. Jefferson St., Springdale, Arkansas, 72765, our telephone number is 479-756-7400, and our internet address is www.aert.com.

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THE OFFERING

Issuer	Advanced Environmental Recycling Technologies, Inc.
Trustee	U.S. Bank National Association
Selling and Servicing Agent	Sumner Harrington Ltd.
Securities Offered	Renewable Unsecured Subordinated Notes. The notes represent our unsecured promise to repay principal at maturity and to pay interest during the term or at maturity. By purchasing a note, you are lending money to us.
Method of Purchase	Prior to your purchase of notes, you will be required to complete a subscription agreement that will set forth the principal amount of your purchase, the term of the notes and certain other information regarding your ownership of the notes. The form of subscription agreement is filed as an exhibit to the registration statement of which this prospectus is a part. As our servicing agent, Sumner Harrington Ltd. will mail you written confirmation once your subscription has been accepted.
Denomination	You can choose the denomination of the notes you purchase in any principal amount of $1,000 or more, including odd amounts.
Offering Price	100% of the principal amount per note.
Rescission Right	You can rescind your investment within five business days of the postmark date of your purchase confirmation without incurring an early redemption penalty. In addition, if your subscription agreement is accepted by our servicing agent at a time when we have determined that a post-effective amendment to the registration statement of which this prospectus is a part must be filed with the Securities and Exchange Commission, but such post-effective amendment has not yet been declared effective, you will be able to rescind your investment subject to the conditions set forth in this prospectus. See Description of the Notes Rescission Right for additional information.
Maturity	You can generally choose maturities for your notes of 6 months or 1, 2, 3, 4, 5 or 10 years; however, depending on our capital requirements, we may not sell notes of all maturities at all times.

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Interest Rate	The interest rate of the notes will be established at the time you purchase them, or at the time of renewal, based upon the rates we are offering in our latest interest rate supplement to this prospectus, and will remain fixed throughout each term. We may offer higher rates of interest to investors with larger aggregate note portfolios, as set forth in the then current interest rate supplement.
Interest Payment Dates	You can choose to receive interest payments monthly, quarterly, semiannually, annually or at maturity. If you choose to receive interest payments monthly, you can choose the day on which you will be paid. You may change the interest payment schedule or interest payment date once during the term of your note.
Principal Payment	We will not pay principal over the term of the notes. We are obligated to pay the entire principal balance of the outstanding notes upon maturity.
Payment Method	Principal and interest payments will be made by direct deposit to the account you designate in your subscription documents.
Renewal or Redemption at Maturity	Upon maturity, the notes will be automatically renewed for the same term at the interest rate we are offering at that time to other investors with similar aggregate note portfolios for notes of the same maturity, unless we notify you prior to the maturity date that we intend to repay the notes. You may also notify us within 15 days after the maturity date that you want your notes repaid. This 15 day period will be automatically extended if you would otherwise be required to make the repayment election at a time when we have determined that a post-effective amendment to the registration statement of which this prospectus is a part must be filed with the Securities and Exchange Commission, but such post-effective amendment has not yet been declared effective. If similar notes are not being offered at the time of renewal, the interest rate upon renewal will be the rate specified by us on or before the maturity date, or the rate of your existing notes if no such rate is specified. The interest rate being offered upon renewal may, however, be different than the interest rate on your original note. See Description of the Notes Renewal or Redemption on Maturity.
Optional Redemption or Repurchase	After giving you 30 days prior notice, we may redeem the notes at a price equal to their original principal amount plus accrued but unpaid interest.

You may request us to repurchase your notes prior to maturity; however, unless the request is due to your death or total permanent disability, we may, in our sole discretion, decline to repurchase your notes, and will, if we elect to repurchase your notes, charge you a penalty of up to six months of interest. The total principal amount of notes that we will be required to repurchase prior to maturity, for any reason in any calendar quarter, will be limited to the greater of $1 million or 2% of the total principal amount of all notes outstanding at the end of the previous quarter.

See Description of Notes Redemption or Repurchase Prior To Stated Maturity.

Consolidation, Merger or Sale

Upon any consolidation, merger or sale of our company, we will either redeem all of the notes or our successor will be required to assume our obligations to pay principal and interest on the notes pursuant to the indenture. For a description of these provisions see Description of the Notes - Consolidation, Merger or Sale.

Ranking; No Security

The notes:

- are unsecured;
- rank junior to our existing and future senior debt, including debt we may incur under our existing and future credit facilities;
- rank junior to our existing and future secured debt;
- rank junior to our existing and future subordinated debt, except for offerings of additional renewable unsecured subordinated notes which will rank equally with the notes;
- rank junior to our existing and future unsecured debt, except for offerings of additional renewable unsecured subordinated notes which will rank equally with the notes; and
- rank junior to other of our financial obligations, including contingent or deferred payment obligations that may in the future be incurred in connection with acquisitions.

As of September 30, 2008, we had approximately $44.6 million of outstanding debt senior to the notes, including approximately $11.2 million of debt outstanding under our $11.4 million revolving credit facility. We intend to retire a portion of this debt with proceeds from the notes. See Use of Proceeds.

Restrictive Covenants

The indenture governing the notes contains only limited restrictive covenants. These covenants:

- require us to maintain a positive net worth; and
- prohibit us from paying cash dividends on our capital stock if there is an event of default with respect to the notes or if payment of the dividend would result in an event of default.

The covenants set forth in the indenture are more fully described under Description of Notes Restrictive Covenants.

Use of Proceeds

If all the notes are sold, with original or aggregate maturities of two years or more, we would expect to receive approximately $46 million of net proceeds from this offering after deducting the selling agent s commissions. The exact amount of net proceeds may vary considerably depending on how long the notes are offered and other factors. We intend to use the net proceeds to repay $20 million in principal under our existing debt, plus accrued interest, to expand our business, build inventory and increase distribution and sales of our green building products, and for other general corporate purposes, including potential acquisitions. See Use of Proceeds.

Absence of Public Market and Restrictions on Transfers

There is no existing market for the notes.

Sumner Harrington Ltd. has advised us that it does not intend to make a market in the notes after the completion of this offering in the U.S. We do not intend to apply for listing of the notes on any securities exchange or for quotation of the notes in any automated dealer quotation system at this time.

You will be able to transfer or pledge the notes only with our prior written consent. See Description of the Notes Transfers.

Book Entry

The notes will be issued in book entry or uncertificated form only. Except under limited circumstances, the notes will not be evidenced by certificated securities or negotiable instruments. See Description of the Notes Book Entry Registration and Transfers.

RISK FACTORS

This prospectus, including the documents incorporated herein by reference, contains certain statements of a forward-looking nature relating to future events or our future performance. These forward-looking statements are based on our current expectations, assumptions, estimates and projections about us and our industry. When used in this prospectus, the words expect, believe, anticipate, estimate, plan, intend and similar expressions are intend identify forward-looking statements. These statements include, but are not limited to, statements of our plans, strategies and prospects under the captions Prospectus Summary, Risk Factors, Use of Proceeds, and other statements contained elsewhere in this prospectus.

These forward-looking statements reflect management s current view of our company concerning future events and are subject to risks and uncertainties. Should any of these risks or uncertainties materialize, or should the underlying assumptions prove incorrect, actual results may vary materially from those described in this prospectus as anticipated, estimated or expected. The cautionary statements made in this prospectus should be read as being applicable to all related forward-looking statements wherever they appear in this prospectus.

The risks described below set forth the material risks associated with the purchase of notes and our company, as well as factors that may influence the outcome of any forward-looking statement. Before you invest in the notes, you should carefully consider these risk factors, as well as the other information contained in this prospectus and in the documents incorporated by reference into this prospectus.

Risk Factors Related to Operating Our Business

We Are Operating Under a Very Short Term Extension of Our $11.4 Million Bank Loan and Are Not in Compliance with its Financial Covenants; the Bank Could Demand Repayment of Such Loan and Foreclose Upon Certain of Our Assets or Force Us into a Bankruptcy Proceeding Before We Can Refinance Such Indebtedness.

Effective September 15, 2008, we renewed our $11.4 million bank line of credit through December 15, 2008, and subsequently received an extension of the due date from the bank to February 15, 2009. The line is secured by inventory, accounts receivable, chattel paper, general intangibles and other current assets, as well as by fixtures and equipment, and is provided by Liberty Bank of Arkansas. The full amount of the line is guaranteed as to payment by our largest stockholder, Marjorie Brooks, and by Joe Brooks and Steve Brooks, two of our executive officers. The credit facility includes a debt service coverage ratio, current ratio, and accounts payable and accounts receivable aging covenants substantially similar to those under our 2007 and 2008 bond agreements, and customary restrictions on dividends and the incurrence of additional debt or liens, among other matters. We were not in compliance with certain of those covenants as of September 30, 2008, and have not received a waiver of those covenants as of February 9, 2009. We are currently working to replace our existing line of credit with a $20 million bridge loan while we seek a larger line of credit or credit facility that will also allow us to finance a vendor managed inventory (VMI) program for ChoiceDek with Lowes for 2009 and 2010. There can be no assurance that we will be successful in obtaining such a bridge loan or a larger working capital line of credit or that it can be obtained on terms favorable to us.

As a result, although we are attempting to obtain funding to repay this loan and are keeping the bank lender apprised of our efforts to do so and are attempting to obtain further extensions and waivers until such refinancing can be successfully completed, this bank loan could immediately become due and payable at any time and the bank lender could foreclose on the property used to secure the debt above at any time, which could force us into a bankruptcy proceeding before we can refinance this indebtedness.

We Are Highly Leveraged and if We Are Unable to Comply With Certain Debt Covenants, Our Financial Position and Operations Could be Adversely Affected.

Our $24.1 million outstanding bond agreements, including our 2008 bonds and our $13.5 million of new bond indebtedness incurred in December 2007 for the development of a new facility in Oklahoma, contain certain financial covenants. The 2007 and 2008 bonds included the following covenants at September 30, 2008: (1) a current ratio of not less than 1.00 to 1.00, (2) that not more than 20% of accounts payable be in excess of 75 days past the invoice date, (3) that not more than 20% of accounts receivable be in excess of 90 days past the invoice or billing date (unless contested in good faith or written off), (4) a requirement that we maintain a long-term debt service coverage ratio for the preceding four quarters of at least 1.50 to 1.00 (changing to 2 to 1 beginning with the quarter ended March 31, 2009, and (5) a debt-to-equity ratio of not more than 3.00 to 1.00 as of any year-end. We were not in compliance with

the accounts payable, current ratio and debt service coverage ratio covenants at September 30, 2008; however, the debt service coverage covenant was waived by the bondholder through January 1, 2009, and the accounts payable and current ratio covenants were waived by the bondholder through January 1, 2010.

Effective September 15, 2008, we renewed our $11.4 million bank line of credit through December 15, 2008, and subsequently received an extension of the due date from the bank to February 15, 2009. The revolving credit facility includes covenants substantially similar to those under our bond agreements and customary restrictions on dividends and the incurrence of additional debt or liens, among other matters. We were not in compliance with certain of those covenants as of September 30, 2008, as discussed above, and had not received a waiver of those covenants as of February 9, 2009. We are currently working to replace our existing line of credit with a $20 million bridge loan while we seek a larger line of credit or credit facility

that will also allow us to finance a vendor managed inventory (VMI) program for ChoiceDek with Lowes for 2009 and 2010. We are currently relying on Weyerhaeuser to carry an adequate level of ChoiceDek inventory to support our sales to Lowe s and will continue to do so until a replacement line of credit is in place. We have recently finalized a formal two-year agreement to supply decking and related materials to Lowe s on a direct basis, with annual renewals thereafter, intended to eliminate Weyerhaeuser s role as the middleman and logistics provider later in 2009. This will require substantially more working capital and a larger line of credit when the inventory build-up for this new supply program begins. The additional financing need is expected to total approximately $50 million and, in addition to subordinated debt such as is expected to be provided through this offering, is expected to require a secured line of credit to fund our anticipated needs for the next year. There can be no assurance that we will be successful in obtaining a larger working capital line of credit or that it can be obtained on terms favorable to us.

There is no assurance that we will be able to comply with our debt covenants in the near future, or that the bondholder or bank lender will continue to waive or modify the covenants in the future. If we are unable to comply with any of the covenants or obtain a waiver or modification of the covenants in the future, except the debt service coverage covenant, then the bond debt, in the amount of $24.1 million at September 30, 2008, could immediately become due and payable and the bondholder could foreclose on the property used to secure the debt, which consists of substantially all of our material operating assets, and the bondholder could claim our revenues pledged as part of the bond agreement. If we are unable to comply with the debt service covenant under the bonds, then we could be required to retain a consultant to make recommendations to increase the debt service coverage ratio to required levels, and to follow those recommendations. We believe it is likely that we will require further waivers of the debt service coverage covenant.

We Have Recently Been Sued by Plaintiffs Alleging Defects in Our Decking Products

On February 26, 2008, plaintiffs filed a purported class action lawsuit seeking to recover on behalf of the purchasers of ChoiceDek composite decking for damages allegedly caused by mold and mildew stains on their decks (Pelletz v. Weyerhaeuser Company, Advanced Environmental Recycling Technologies, Inc. and Lowe s Companies, Inc. pending in U.S. District Court, Western District of Washington (Seattle Division)). The plaintiffs originally sued AERT, Weyerhaeuser Company, and Lowe s Companies, Inc., asserting causes of action for alleged violations of the Washington Consumer Protection Act and other state consumer protection acts, breach of implied warranty of merchantability, breach of express warranty, and violations of the Magnuson-Moss Warranty Act.

On March 10, 2008, unrelated plaintiffs filed a similar purported class action lawsuit seeking to recover on behalf of the purchasers of ChoiceDek composite decking for damages allegedly caused by mold and mildew stains on their decks. (Joseph Jamruk et al v. Advanced Environmental Recycling Technologies, Inc. and Weyerhaeuser Company in U.S. District Court, Western District of Washington (Seattle Division)) The plaintiffs sued AERT and Weyerhaeuser Company, asserting causes of action for actionable misrepresentation, alleged violations of the Washington Consumer Protection Act, unjust enrichment, and breach of express warranty. On May 19, 2008, the plaintiffs in both cases filed a consolidated complaint against AERT and Weyerhaeuser Company.

On August 21, 2008, the parties filed with the court a class action settlement agreement for preliminary approval. The settlement includes decking material purchased from January 1, 2004 through December 31, 2007, along with decking material purchased after December 31, 2007 which was manufactured before October 1, 2006 before a mold inhibitor was included in the manufacturing process. The court approved the class action settlement on January 9, 2009.

As part of the settlement, the defendants have agreed not to use the terms minimum maintenance, low maintenance, easy to maintain, or virtually maintenance free in ChoiceDek marketing materials. AERT will also provide additional cleaning instructions on the ChoiceDek website to assist customers with cleaning their decks. AERT will provide national notice of the settlement to putative class members and establish a call center to answer customer questions regarding ChoiceDek. AERT will also self-administer a claim resolution process whereby eligible deck owners may file a claim for significant mold spotting within six months of when the settlement becomes final and unappealable. If eligible, deck owners who timely file a claim for significant mold spotting may receive relief such as deck cleanings and applications of a mold inhibitor, gift cards for use at Lowe s, replacement materials, and/or refunds under certain criteria. An arbitration provision is included in the settlement agreement, which provides for disputes arising from the claim resolution process.

AERT has recorded expenses of $5.6 million associated with the settlement of the class action lawsuit. The estimate includes $2.9 million for the claims resolution process, $0.2 million to be paid to the Company s attorneys, $0.8 million for costs to provide notice to the class, and $1.8 million for plaintiffs attorney fees to be paid over 2008 and 2009. The claim resolution process will have an annual cost limitation to AERT of $2.8 million in 2009, $2.8 million in 2010, and if necessary, $2.0 million per year thereafter until the claim resolution process is completed.

We May Have Insufficient Working Capital to Achieve Our Growth Objectives.

While at December 31, 2007, we had a working capital surplus of $2.2 million, we had a deficit of $10.0 million at September 30, 2008. The current working capital deficit was the result of losses from operations, defense and settlement of a recent class action lawsuit, our decision to finance capital projects with cash generated from operations, and our need to fund rapid growth in sales. Our 2007 year end positive working capital was attributable to new preferred equity and bond financings we completed in the fourth quarter of 2007, aggregating $23.5 million. There is no assurance that we will be able to regain a working capital surplus.

The Demand For Our Products is Influenced by General Economic Conditions and May be Adversely Affected by General Economic Downturns or Declines in Construction Activity

Our products are sold in the home improvement, remodeling, and new home construction markets. These markets are subject to significant fluctuations in activity and periodic downturns caused by general economic conditions, as has been the case since mid-2006, which contributed substantially to the decline in our revenues from $98 million in 2006 to $82 million in 2007 and to the resulting net losses we experienced in 2007. Slowdowns in the economy or construction activity may result in a reduction of the demand for our products and adversely affect our profitability. High heating oil prices have also increased the demand for and prices of waste wood fiber which is increasingly being used as fuel pellets. This may substantially reduce funds available for home improvement or remodeling while also further increasing our costs of acquiring waste wood fiber. A worsening of the current economic climate, including escalation of oil and petrochemical prices, further deterioration of the credit markets and/or consumer confidence, will negatively impact our sales and profitability.

The Loss of One Or More of Our Key Customers Could Cause a Substantial Reduction in Our Revenues and Profits.

We could be materially adversely affected if we were to lose one or more of our large existing customers. Our principal customer for our decking material is Lowe s, which we have supplied through our distributor, Weyerhaeuser. Sales to Weyerhaeuser accounted for 75% and 81% of our sales in 2007 and

2006, respectively, and accounted for 77% of our sales for the nine months ended September 30, 2008. We recently finalized terms to acquire the ChoiceDek brand from Weyerhaeuser, and we entered into a two-year agreement beginning in 2009, with an option exercisable by Lowe s for two more years, to sell ChoiceDek and accessories direct to Lowe s. ChoiceDek is currently sold in over 1,570 Lowe s stores in North America. A few large door and window construction companies have historically purchased substantially all of our industrial component products. A loss of any one of our large customers would adversely affect our sales and profitability.

We May be Unable to Secure an Adequate Quantity of Quality Raw Materials at Economical Prices.

Our products are constructed primarily from waste wood fiber and scrap polyethylene. The markets for such materials are dynamic. The global demand for these materials has increased significantly and we expect demand to continue to increase. The largest component of our raw material costs is scrap polyethylene. The price that we must pay for these materials is related to the market prices of natural gas and petroleum, which have been rising and volatile in recent years. Our future profitability is contingent on our ability to successfully recycle polyethylene plastic and being able to manage raw material costs under these circumstances and to successfully and timely open and operate the Watts, Oklahoma project, which will utilize lower cost grades of plastic scrap and hedge against further price increases.

Weather

Sales of decking and accessories are subject to weather and seasonality trends associated with outdoor construction. Our current product mix is sold year-round, but experiences significantly higher retail sales during the second and third quarters, which run from April through September. Thus, adverse or bad weather, to which we are more susceptible during the first or fourth quarters, could result in a negative impact on sales.

Fire Disruptions May Adversely Affect Our Ability to Operate Our Business.

Our raw materials and manufacturing processes involve a greater than average risk of fire loss or disruption. Throughout our history, we have experienced several fires, some of which severely disrupted our manufacturing operations. There was an accidental fire at our Junction, Texas facility in March 2003, which caused substantial damage and temporarily shut down plant operations, and there was a silo fire at our Springdale South facility in Arkansas on May 21, 2008 that temporarily required a shutdown of an extrusion line at that facility. Although we have increased security and increased fire protection equipment at our facilities, another major fire could occur and materially adversely affect our operations.

Our Strategy of Using Recycled Plastic and Waste Wood to Create a Competitive Cost Advantage Involves Significant Risks, the Occurrence of Which May Materially Adversely Affect Our Profitability.

Our business strategy is to provide an environmentally friendly product at a competitive price. To achieve our business objectives we must recycle plastic and process waste wood on a cost-effective basis and efficiently convert these materials into high-quality finished goods. This strategy involves significant risks, including the risks that:

Our profitability may be materially diminished. The intrinsic variability of our raw material sources can result in considerable reduction in our operating rates and yields, which may more than offset any savings we realize from the purchase price of the materials.

We may not produce a sustainable return on investment. Because our production model requires backward integration in plastic recycling operations, as well as customized solutions for material preparation, compounding and extrusion, our model is significantly more capital intensive on a per-

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unit-basis than the models of our typical competitors. Our plants must convert our raw materials at high rates and net yields to generate the profit margins and cash flows necessary to sustain our business.

We may be limited in the markets in which we can effectively compete. Successfully expanding our business beyond decking, trim, and fencing pickets would require applying our formulation and process technology to increasingly more challenging applications, such as high-end railing systems. The greater complexity and tighter design tolerances of such profiles require a level of process control that is more stringent than the level involved in deck board production. Our raw materials and process technology may not permit us to develop new applications on a cost-effective basis.

Environmental Regulation Exposes Us to Potential Liability for Response Costs and Damages to Natural Resources.

We are subject to federal, state, and local environmental laws and regulations. The environmental laws and regulations applicable to our operations establish air quality standards for emissions from our manufacturing operations, govern the disposal of solid waste, and regulate wastewater and storm water discharge. As is the case with manufacturers in general, we may be held liable for response costs and damages to natural resources if a release or threat of release of hazardous materials occurs on or from our properties or any associated offsite disposal location, or if contamination from prior activities is discovered at any properties we own or operate.

We have Identified Certain Weaknesses in Our Internal Controls.

Our management identified three material weaknesses in our internal control over financial reporting as of December 31, 2007, two of which were also cited as weaknesses in our internal controls as of December 31, 2006. Management concluded that we did not have an adequate process in place to assess potential impairment of fixed assets, that our inventory costing system was not adequately documented nor were there adequate procedures for an independent review of the costing analysis to ensure completeness and accuracy of the calculated costs, all of which were rated as weaknesses last year and which we have been in the process of remediating. Additionally, at the entity level, we had not properly allocated resources to ensure that necessary internal controls were implemented and followed throughout AERT. We have recently hired a new CFO with public company experience and upgraded our accounting department. We are in the process of remediating the weaknesses in our internal controls; however, there can be no assurance at this time that our remediation plans and the actions we take will effectively remediate the material weaknesses.

We Must Maintain Product Quality and Innovation at Competitive Costs

Our ability to grow and continue to gain market share is dependent on our ability to maintain the quality and performance of our products at reasonable costs. We have invested heavily in technology and infrastructure since inception to process and reformulate recycled materials in to high quality building products. However, if we should experience any problems or negative perceptions with product quality, it could have a negative impact on net sales. We were recently sued in federal district court in Washington in regard to an alleged surface cleaning defect with one of our product lines.

With ever increasing competition and with an increasing number of new products entering the marketplace, we must maintain the quality and performance of our products while constantly addressing the needs of our customers in the marketplace. This involves offering a broader selection of high quality products on a routine basis, while being able to maintain acceptable manufacturing rates and yields at competitive costs. If we cannot maintain acceptable manufacturing rates and yields in producing new products in a timely manner, our costs may be higher. This could impede our introduction of new products and negatively affect our profitability.

We Will Likely Need to Raise Additional Capital in the Future. If We Need Additional Funding, But Fail to Obtain it, We May Not Be Able to Adequately Develop and Commercialize Our Products or Improve or Expand Our Operations.

We may need to raise additional outside financial resources in the future to effectively compete in the composite building materials marketplace, finance increased inventories, execute our current and future business plans and/or further develop and commercialize our current and future product offerings. Inability to raise sufficient outside capital would likely materially adversely impact our business, operations and profitability.

Our Failure to Maintain Nasdaq Listing Requirements Could Cause Our Common Stock to be Delisted.

Since December 21, 2007, we have failed to satisfy the Nasdaq minimum closing bid price of $1.00 per share and could be subject to Nasdaq delisting procedures if such noncompliance is not rectified on or before June 21, 2009. If the stock price does not increase to $1.00 or more for at least 10 consecutive trading days to re-establish compliance with Nasdaq s listing requirement prior to that date, we intend to effectuate a reverse stock split. On July 24, 2008, our stockholders approved a potential reverse stock split to be effectuated by December 15, 2008 at a ratio to be determined by the board of directors between one-to-two and one-to-five; however, we will need to seek shareholder approval again as the deadline for the reverse split has passed and we will likely need to change the ratio of the reverse split given the decrease in our stock price since the original range of ratios was approved.

The loss of our Nasdaq listing would likely reduce trading activity in our common stock and make it more difficult for stockholders to sell their shares, and the threat of such a result could have a negative or dampening effect on our trading activity until such matter is resolved. Any decreased trading activity and added difficulty in trading our stock could have a negative impact on our stock price. Failure to maintain our Nasdaq listing, or to then be listed on the OTC Bulletin Board, would also result in the Series D preferred stockholders having an option to require us to redeem all of the outstanding Series D preferred stock at a price equal to 120% of its stated value plus accrued dividends. The redemption amount is payable at our option in either Class A common stock (valued at the lower of the then applicable conversion price or an average price based upon the 30 trading days preceding the redemption) or cash.

We Are Subject to Many Restrictions in Our Credit Facility and Bond Documents.

The terms of our credit facility and bond documents impose significant operating and financial restrictions on us and require us to meet certain financial tests. Such terms and restrictions may be amended or supplemented from time to time without requiring any notice to or consent of the holders of the notes or the trustee. These restrictions may have an adverse impact on our business activities, results of operations and financial condition. These restrictions may also significantly limit or prohibit us from engaging in certain transactions, including the following:

- incurring or guaranteeing additional indebtedness, including in connection with future acquisitions;
- making capital expenditures in excess of agreed upon amounts;
- paying dividends or other distributions to our stockholders or redeeming, repurchasing or retiring our capital stock or subordinated obligations;
- making investments;
- creating or permitting liens on our assets or the assets of our subsidiaries;
- issuing or selling capital stock;
- transferring or selling our assets;

- engaging in mergers or consolidations;
- permitting a change of control of our company;
- liquidating, winding up or dissolving our company;
- changing our name or the nature of our business; and
- engaging in transactions with our affiliates outside the normal course of business.

These restrictions may limit our ability to obtain additional sources of capital, which may limit our ability to repay the notes. In addition, the failure to comply with any of the covenants of our credit facility or the indenture or to maintain certain indebtedness ratios would cause a default under our credit facility and may cause a default under the indenture or our other debt agreements that may be outstanding from time to time. A default, if not waived, could result in acceleration of the related indebtedness, in which case such debt would become immediately due and payable. A continuing default or acceleration of our credit facility, the indenture or any other debt agreement, will likely cause a default under the indenture and other debt agreements that otherwise would not be in default, in which case all such related indebtedness could be accelerated. If this occurs, we may not be able to repay our debt or borrow sufficient funds to refinance our indebtedness. Even if any new financing is available, it may not be on terms that are acceptable to us or it may not be sufficient to refinance all of our indebtedness as it becomes due. Complying with these covenants may cause us to take actions that are not favorable to holders of the notes. See Description of the Notes Restrictive Covenants.

Management May be in a Position to Control the Company.

Directors and officers of AERT currently own approximately 33% of the outstanding Class A common stock and stock representing approximately 37% of the combined voting power of the Class A and Class B common stock. The ownership and voting percentages include stock owned by the Brooks family representing approximately 29% of the Class A common stock and 33% of the combined voting power.

Our Patents and Proprietary Rights May Not Adequately Protect Our Technologies or Products.

Our commercial success will depend, in part, on our ability to obtain patents and maintain adequate protection for our technologies and products. Although we believe we have patent protection on the most important aspects of our current composite product until 2015, we have five patents expiring in 2010 and could lose patent protection as to certain elements of our production process as a result. We will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that our proprietary technologies and products are covered by valid and enforceable patents or are effectively maintained as unpatented proprietary technology. If we do not adequately protect our intellectual property, competitors may be able to use our technologies and erode or negate any competitive advantage we may have, which could harm our business and ability to achieve profitability. Our ability to maintain and solidify our proprietary position for our products will depend on our success in obtaining effective claims and enforcing those claims once granted.

We also rely on trade secrets to protect some of our technology, especially where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to maintain. While we use reasonable efforts to protect our trade secrets, our employees, consultants, contractors or other advisors may unintentionally or willfully disclose our proprietary information to competitors. Enforcement of claims that a third party has illegally obtained and is using trade secrets is expensive, time consuming and uncertain. In addition, non-U.S. courts are sometimes less willing than U.S. courts to protect trade secrets. If our competitors independently develop equivalent knowledge, methods and know-how, we would not be able to assert our trade secrets against them and our business could be harmed.

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Risk Factors Relating to the Notes

The Notes May Not Be a Suitable Investment For All Investors.

An investment in the notes involves a high degree of risk. The notes may not be a suitable investment for you, and we advise you to consult your investment, tax and other professional financial advisors prior to purchasing notes. The characteristics of the notes, including maturity, interest rate and lack of liquidity, may not satisfy your investment objectives. The notes may not be a suitable investment for you based on your ability to withstand a loss of interest or principal or other aspects of your financial situation, including your income, net worth, financial needs, investment risk profile, return objectives, investment experience and other factors. Prior to purchasing any notes, you should consider your investment allocation with respect to the amount of your contemplated investment in the notes in relation to your other investment holdings and the diversity of those holdings.

You Lack Priority in Payment on the Notes, Which Rank Junior to Substantially All of Our Existing and Future Debt and Other Financial Obligations.

Your right to receive payments on the notes is junior to substantially all of our existing indebtedness and future borrowings. Your notes will be subordinated to the prior payment in full of all of our other debt and financial obligations. We have, in recent periods, not been in compliance with covenants on senior debt and have had to seek and obtain waivers on these covenants. As of September 30, 2008, we had approximately $67.2 million of indebtedness, which includes approximately $22.6 million of trade payables and other accrued liabilities. Assuming we sell the full aggregated principal amount, we expect to retire approximately $20 million of this with the proceeds of this offering. This indebtedness will rank senior to your notes while it remains outstanding. Although we intend to repay this existing indebtedness, we also intend to seek to enter into agreements with creditors to provide further credit facilities. Any credit facility entered into with other creditors will rank senior to the notes being offered. We may also incur substantial additional indebtedness in the future that would also rank senior to your notes. Because of the subordination provisions of the notes, in the event of our bankruptcy, liquidation or dissolution, our assets would be available to make payments to you under the notes only after all payments had been made on all of our secured and unsecured indebtedness and other obligations that are senior to the notes. Sufficient assets may not remain after all such senior payments have been made to make any payments to you under the notes, including payments of interest when due or principal upon maturity.

There Will Be No Trading Market for the Notes, Which May Make it Difficult to Transfer Your Notes.

Your ability to liquidate your investment is limited because of transfer restrictions, the lack of a trading market and the limitation on repurchase requests prior to maturity. Your notes may not be transferred without our prior written consent. In addition, there will be no trading market for the notes. Due to the restrictions on transfer of the notes and the lack of a market for the sale of the notes, even if we permitted a transfer, you might be unable to sell, pledge or otherwise liquidate your investment. Except in the case of death or total permanent disability, repurchases of the notes prior to maturity are subject to our approval and to repurchase penalties of up to three months interest on notes with three month maturities and up to six months interest on notes with maturities of six months or longer. The total principal amount of notes that we would be required to repurchase in any calendar quarter, for any reason, will be limited to the greater of $1 million or 2% of the aggregate principal amount of all notes outstanding at the end of the previous quarter. See Description of the Notes.

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The Notes Will Have No Sinking Fund, Security, Insurance or Guarantee.

There is no sinking fund, security, insurance or guarantee of our obligation to make payments on the notes. The notes are not secured by any of our assets. We will not contribute funds to a separate account, commonly known as a sinking fund, to make interest or principal payments on the notes. The notes are not certificates of deposit or similar obligations of, and are not guaranteed or insured by, any depository institution, the Federal Deposit Insurance Corporation, the Securities Investor Protection Corporation, or any other governmental or private fund or entity. Therefore, if you invest in the notes, you will have to rely only on our cash flow from operations and other sources of funds for repayment of principal at maturity or redemption and for payment of interest when due. If our cash flow from operations and other sources of funds are not sufficient to pay the notes, then you may lose all or part of your investment.

The Notes Will Automatically Renew Unless You Request Repayment.

Upon maturity, each note will be automatically renewed for the same term as your maturing note to which it corresponds and at an interest rate that we are offering at that time to other investors with similar aggregate note portfolios for notes of the same term, unless we notify you prior to the maturity date that we intend to repay the notes or you notify us within 15 days after the maturity date that you want your notes repaid. This 15 day period will be automatically extended if you would otherwise be required to make the repayment election at a time when we have determined that a post-effective amendment to the registration statement of which this prospectus is a part must be filed with the Securities and Exchange Commission, but such post-effective amendment has not yet been declared effective. If notes with the same term are not then being offered, the interest rate upon renewal will be the rate specified by us on or before the maturity date, or the rate of the existing note if no such rate is specified. The interest rate on your renewed note may be lower than the interest rate of your original note. Any requests for repurchases after your notes are renewed will be subject to our approval and to repurchase penalties and the limitations on the amount of notes we would be willing to repurchase in any calendar quarter.

If we do not maintain an effective registration statement for or qualification of the notes under applicable state securities laws or otherwise comply with applicable state securities laws, the notes will not automatically renew.

As a condition to the renewal of the notes, we must maintain an effective and current registration statement covering the notes, maintain qualification of the notes, or the notes must be exempt under the applicable securities laws of the states in which certain investors live. We cannot assure you that we will continue to maintain a current registration statement for or qualification of the notes in any state or that the notes will be exempt under the securities laws of any state. At the time of the maturity of each note, if a current registration statement for or qualification of the notes is not in effect under the laws of a state in which the holder of the note resides, or an exemption is not available to us under the securities laws of such state, we will not be permitted to automatically renew the note held by the investor living in such state. If the notes may not be renewed because of our failure to maintain an effective registration statement for or qualification of the notes under applicable state securities laws or our failure to otherwise secure an exemption for the renewal under applicable state securities laws, we will be required to repay the notes, which we may not be able to do.

We Have Substantial Indebtedness That is Senior to the Notes, Which May Affect Our Ability to Repay the Notes

We have now and, after we sell these notes, will continue to have a substantial amount of indebtedness. At September 30, 2008 we had total indebtedness of $67.2 million for purposes hereof, which includes $22.6 million of trade payables and other accrued liabilities and $44.6 million of debt outstanding comprised of:

Allstate Bonds	$24.1 million
Allstate Bridge Loan	5.0 million
Allstate Loan	0.8 million
Liberty Bank Loan	1.8 million
Liberty Bank Line of Credit	11.2 million
Capital Leases	0.9 million
Other notes	0.8 million

Our debt to net worth ratio at September 30, 2008 was 2.2 to 1.

Our substantial indebtedness could adversely affect our financial condition and prevent us from fulfilling our obligations under the notes by, among other things:

- increasing our vulnerability to general adverse economic and industry conditions;
- requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing amounts available for working capital, capital expenditures and other general corporate purposes;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- placing us at a competitive disadvantage compared to our competitors that have less debt; and,
- limiting our ability to borrow additional funds.

We Might Incur Substantially More Indebtedness That Will Be Senior to Your Notes.

Subject to limitations contained in our credit facility, we may incur substantial additional indebtedness in the future. While the indenture for the notes requires us to maintain a positive net worth, it does not prohibit us from incurring additional indebtedness. Any such borrowings would be senior to the notes. If we borrow more money, the risks to noteholders described in this prospectus could intensify.

Our Management Has Broad Discretion Over the Use of Proceeds From the Offering.

We expect to use the proceeds from the offering to repay approximately $20 million in principal under our existing senior indebtedness, plus accrued interest. However, the indenture does not require us to use the proceeds from the offering for these specific purposes, and additional senior indebtedness may be incurred even after such a payment. The proceeds of the offering will also be used for other general corporate purposes, which may include the payment of general and administrative expenses. Because no specific allocation of the proceeds will be required in the indenture, our management will have broad discretion in determining how the proceeds of the offering will be used, may choose not to use the funds to pay down debt that is senior to the notes and may not use the proceeds in ways that f