

**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 19, 2007**

To our Stockholders:

The annual meeting of stockholders of Advanced Environmental Recycling Technologies, Inc. will be held at the Northwest Arkansas Holiday Inn Convention Center, Springdale, Arkansas at 7:00 p.m., local time, Thursday, July 19, 2007, 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 eleven members to the eleven-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, 2007; and
3. 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 May 23, 2007, 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 18, 2007

A proxy card and annual report of the company for the year ended December 31, 2006, 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.

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**Annual Meeting of Stockholders  
July 19, 2007**

**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 at the Northwest Arkansas Holiday Inn Convention Center, Springdale, Arkansas, at 7:00 p.m. local time, Thursday, July 19, 2007, and at any adjournments thereof. The notice of meeting, proxy statement, and form of proxy are being mailed to stockholders on or about June 19, 2007.

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 May 23, 2007, the record date, there were 45,780,570 shares of Class A common stock and 1,465,530 shares of Class B common stock issued and outstanding. Each outstanding share of Class A common stock entitles the holder thereof to one vote on matters submitted to the stockholders and each share of Class B common stock entitles the holder thereof to five votes on matters submitted to the stockholders. As of May 23, 2007, the holders of the Class B common stock are entitled to an aggregate of 7,327,650 votes. The holders of record of the Class A common stock and Class B common stock outstanding on May 23, 2007, 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 May 23, 2007, the Company's executive officers and directors (but giving effect to the addition of Peter Lau to the board of directors) beneficially owned approximately 35.7% 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 43.3% 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 30.1% of the votes entitled to be cast and may be in a position to control the Company.

The following table sets forth, as of May 23, 2007, certain information with regard to the beneficial ownership of the Company's capital stock by each holder of 5% or more of the outstanding stock, by each named executive officer and director of the Company (but giving effect to the addition of Peter Lau to the board of directors), and by all officers and directors as a group:

<u>Name and Address of Beneficial Owner</u>	<u>Title of Class(1)</u>	<u>Number of Shares of Common Stock(2)</u>	<u>Percentage of Class Outstanding(2)(16)</u>	<u>Percentage of Total Voting Power(2)(17)</u>
Marjorie S. Brooks . . . . .	Class A	12,164,409(3)	25.9%	30.1%
	Class B	837,588(4)	57.2%	
Joe G. Brooks . . . . .	Class A	896,772(5)	1.9%	4.3%
	Class B	284,396	19.4%	
J. Douglas Brooks . . . . .	Class A	894,065(6)	2.0%	2.9%
	Class B	131,051	8.9%	
Jerry B. Burkett . . . . .	Class A	303,424(7)	*	*
	Class B	33,311	2.3%	
Sal Miwa . . . . .	Class A	206,787(8)	*	*
Stephen W. Brooks . . . . .	Class A	821,112(9)	1.8%	2.4%
	Class B	89,311	6.1%	
Jim Robason . . . . .	Class A	198,718(10)	*	*
Melinda Davis . . . . .	Class A	234,902(11)	*	*
Michael M. Tull . . . . .	Class A	1,005,938(12)	2.2%	1.9%
Peter S. Lau . . . . .	Class A	27,500(13)	*	*
Tim W. Kizer . . . . .	Class A	5,256(14)	*	*
Edward P. Carda . . . . .	Class A	5,256(14)	*	*
Robert Thayer . . . . .	Class A	200,000(15)	*	*
Jim Precht . . . . .	Class A	407,700(16)	*	*
Alford Drinkwater . . . . .	Class A	10,000(17)	*	*
Officers and directors . . . . .		17,381,839		
as a group (fifteen persons):				
P. O. Box 1237 . . . . .	Class A		35.7%	43.3%
Springdale, AR 72765 . . . . .	Class B		93.9%	

\* Less than 1%

- (1) The Class B common stock is substantially identical to the Class A common stock, except that each share of Class B common stock has five votes per share and each share of Class A common stock has one vote per share. 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 (July 22, 2007) of May 23, 2007.
- (3) Includes 9,851,619 shares owned directly, 1,121,457 in trusts or corporations controlled by Mrs. Brooks, 375,000 shares issuable upon exercise of stock options, 323,000 shares issuable upon exercise of Series X and Y warrants owned directly and 493,333 shares issuable upon exercise of Series X and Series Y Warrants owned indirectly through two corporations controlled by Mrs. Brooks (Razorback Farms, Inc. and Brooks Investment Company).
- (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 607,400 shares owned directly, 4,500 shares owned as custodian for Joe G. Brooks' minor child, 38,205 shares owned as custodian for Brooks' Children's Trust and 246,667 shares issuable upon exercise of stock options.
- (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, and 175,000 shares issuable upon exercise of stock options.
- (8) Includes 13,424 shares owned directly and 193,363 shares issuable upon exercise of stock options.
- (9) Includes 821,112 shares owned directly.
- (10) Includes 112,918 shares owned directly, 60,800 shares issuable upon exercise of Series X and Series Y warrants, and 25,000 shares issuable upon exercise of stock options.
- (11) Represents 32,436 shares owned directly, 66,666 shares in a trust controlled by Ms. Davis, 75,000 shares issuable upon exercise of stock options, and 60,800 shares issuable upon exercise of Series X and Series Y warrants.
- (12) Includes 745,938 shares owned directly, 100,000 shares issuable upon exercise of stock options, and 160,000 shares issuable upon exercise of Series X and Series Y warrants.
- (13) Includes 2,500 shares owned directly and 25,000 shares issuable upon exercise of stock options.
- (14) Includes shares issuable pursuant to restricted stock awards.
- (15) Includes 10,000 shares owned directly and 190,000 shares issuable upon exercise of stock options.
- (16) Includes 7,700 shares owned directly and 400,000 shares issuable upon exercise of stock options.
- (17) Includes 10,000 shares owned directly.
- (18) 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 May 23, 2007, and (ii) the total shares underlying outstanding warrants and options which the named individual had the right to acquire within 60 days (July 22, 2007) of May 23, 2007. Class B common stock beneficial ownership is calculated based on 1,465,530 shares outstanding on May 23, 2007.
- (19) 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 May 23, 2007, and (ii) the total shares underlying outstanding warrants and options which the named individual had the right to acquire within 60 days (July 22, 2007) of May 23, 2007.

At May 23, 2007, there were 45,780,570 shares of Class A common stock and 1,465,530 shares of Class B common stock issued and outstanding. The previous table indicates that those directors, officers and 5% shareholders, as a group, beneficially owned shares representing approximately 43.3% of the votes entitled to be cast upon matters submitted to a vote of the Company's stockholders, and Marjorie S. Brooks and corporations controlled by her beneficially owned shares representing approximately 30.1% of the votes entitled to be cast and may be in a position to control the Company.

## DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

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

<u>Name</u>	<u>Age</u>	<u>Position</u>
Joe G. Brooks . . . . .	51	Chairman of the board of directors, co-chief executive officer and president
Sal Miwa . . . . .	50	Vice-chairman of the board of directors
Stephen W. Brooks . . . . .	50	Co-chief executive officer and director
Marjorie S. Brooks . . . . .	71	Secretary, treasurer and director
J. Douglas Brooks . . . . .	47	Senior vice-president — sales and marketing
Alford Drinkwater . . . . .	55	Senior vice president — administration
Jim Precht . . . . .	61	Senior vice-president — sales and marketing
Robert A. Thayer . . . . .	55	Senior vice-president and chief financial officer
Eric E. Barnes . . . . .	33	Controller and chief accounting officer
Jerry B. Burkett . . . . .	50	Director
Edward P. Carda . . . . .	66	Director
Melinda Davis . . . . .	64	Director
Tim W. Kizer . . . . .	41	Director
Peter S. Lau . . . . .	53	Director
Jim Robason . . . . .	69	Director
Michael M. Tull . . . . .	52	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, and he has served as president since February 2000. In July 2006 he was appointed as the 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.

**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 CEO and chairman of Greenstone Holdings, Inc.(OTC "GSHG"), a chemical technology company located in New York City primarily serving the building and construction industry. 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.

The Company's board of directors elected **Stephen W. Brooks** as chief operating officer in July 2006. Mr. Brooks has served as its chief executive officer and co-chief executive officer, and 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.

**J. Douglas Brooks** has served as a senior vice-president from the Company's inception. He is currently senior vice president responsible for MoistureShield sales, but has previously managed the raw material sourcing and strategic relationships group, the plastics division, and AERT's polyethylene recycling program with The

Dow Chemical Company. Mr. Brooks is a joint inventor on several of AERT's process patents for recycling polyethylene film for composites.

**Robert A. Thayer** has been senior vice president and chief financial officer since September 2005. From October 2002, to September 2005 he served as assistant to AERT chairman Joe G. Brooks, during which time he has had executive assignments in all aspects of AERT's business including finance, operations, and administration. From January 1997 to October 2002, Mr. Thayer was a principal at Madison Research, Denison, Texas where he conducted independent financial research under contract to banks and financial publishers. From January 2001 to July 2002 he also served as Vice President of Finance for Asia Teletech Company, Ltd., a Thailand headquartered voice-over-internet company where he was responsible for raising the company's startup capital. Prior to 1997, Mr. Thayer spent twenty-one years in the software and investment banking industries with financial, systems and executive responsibilities. He received a BA in Economics from the University of Colorado and studied graduate economics at the University of Wisconsin, Madison. Mr. Thayer is a Chartered Financial Analyst.

**Alford Drinkwater** has served as senior vice president of administration since April of 2005. 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 starting in November 1988. 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** has served as the Company's chief sales and marketing officer since February 2001. Mr. Precht was formerly general manager of Weyerhaeuser Building Materials' Pittsburgh Customer Service Center with 32-years of building industry experience.

**Eric E. Barnes** was appointed by the board of directors as chief accounting officer in September 2005. 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 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.

**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.

**Tim W. Kizer** was elected to the board of directors in July 2005. Since December 2004, Mr. Kizer has served as the president of Bentonville Global Associates, a performance improvement consultancy firm. Mr. Kizer is also a Partner in 71 Ventures, an Arkansas-based merchant bank focusing on the creation and success of organizations

with environmentally sustainable products and processes. 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 at the Sam M. Walton College of Business. Mr. Kizer was also the Managing Director of the Information Technology Research Center at the University of Arkansas and co-founded the Doing Business in Bentonville speaker series. He has a B.A. from the University of Louisville, Kentucky.

**Peter S. Lau** has been president of Greenstone Holdings, Inc., an international investment banking firm since 2002. Prior to that, he served as a director and chief executive officer of Cathay One, Inc. and was the chief financial officer of Cathay Online, Inc. He was formerly the managing director of corporate finance of American Fronteer Financial Corporation (AFFC), previously known as RAF Financial Corporation, and is a former associate of Heng Fung Capital Inc., a merchant-banking group based in Hong Kong. Mr. Lau previously served on AERT's board of directors from 1997 to 2000. He is a graduate of the University of Hartford with a B.S. and M.S. in accounting and is a Certified Public Accountant.

**Jim Robason** has served on the board of directors since July 2003. Since January 2005, Mr. Robason has been a consultant to the Company in the areas of plant operations and construction. Mr. Robason joined Allen Canning Co. in 1967 and served as senior vice-president — operations from 1974 until his retirement in 2002. As senior vice-president of operations with Allen Canning, 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 is knowledgeable 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 served on Allen Canning's executive committee and profit sharing/retirement plan committee in addition to his operations responsibilities.

**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 that 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 the boards of several closely held family businesses and is a member of the board of directors of 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 sons of Marjorie S. Brooks. 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, Melinda Davis, Tim W. Kizer, Peter S. Lau, and Sal Miwa are independent under the NASDAQ Stock Market's ("NASDAQ") corporate governance listing standards, and that Marjorie S. Brooks, secretary and treasurer, 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 2006, 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 2006 stockholder meeting.

## Board Meeting and Certain Committees Reports and Meetings

During the Company's fiscal year ended December 31, 2006, the board of directors held eight meetings. All directors attended 85% 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, 2006 through June 8, 2006, 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 June 9, 2006, the Board appointed Jerry B. Burkett, Melinda Davis (chairperson) and Edward P. Carda to the audit committee. The composition of the audit committee has not changed since June 9, 2006. 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 2006. Melinda Davis serves as the financial expert on the audit committee.

From January 1, 2006 through June 8, 2006, the compensation committee consisted of Samuel L. Milbank (chairperson), Sal Miwa and Edward P. Carda. On June 9, 2006, Tim W. Kizer joined the committee. 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 2006.

From January 1, 2006 through June 8, 2006, the nominating and corporate governance committee consisted of Jerry B. Burkett (chairperson), Melinda Davis, and Tim W. Kizer. On June 9, 2006, Sal Miwa joined the committee and Tim Kizer left the committee. 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 2006.

The nominating and corporate governance committee believes that candidates for director should have certain minimum qualifications, including being able to read and understand basic 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 at least 180 days in advance of the 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](http://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 2006 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, 2005. 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 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, 2006, 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 2006. No other non-audit related services were provided by TTS&S during 2006.

Submitted by the audit committee,

Jerry B. Burkett

Edward P. Carda

Melinda Davis, chairperson

## COMPENSATION DISCUSSION AND ANALYSIS

### Overview of Compensation Program

AERT's executive compensation program is designed to achieve the Company's goal of attracting, developing and retaining business leaders who can drive financial and strategic growth objectives that are intended to maximize long-term shareholder 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 the Company's executive compensation programs:

- **Competitiveness** — All components of compensation should be set competitively as compared against appropriate peer companies so that the Company 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 the Company 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 Shareholders' Interests — Long-term incentives should align decision making with the interests of the Company's shareholders.

### **Compensation Philosophy and Objectives**

The Company's executive compensation program is designed to:

- Attract, motivate and retain executive officers who can make significant contributions to the Company's long-term success;
- Align the interests of executive officers with those of shareholders; and
- Place a significant portion of an executive officer's total compensation at risk by tying it to the Company's 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 the Company's 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 the Company's obligations under such circumstances. 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 to administer compensation plans and make recommendations to the Board of Directors with respect thereto;
- The performance of the executive officers and award incentive compensation and adjust 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 the Company's 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 the Company's 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 the Company 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 the Company competes for executive talent. In determining the extent and nature of discretionary awards, the Committee considers the Company's 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 the Company's 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 shareholders 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 prior Company plans could be made in the form of stock options, restricted stock units, performance awards and 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 the Company, the Company has determined for the foreseeable future to provide incentive equity compensation in the form of restricted stock 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 reflect this shift in compensation policy.

The Committee has reviewed and approved a compensation plan for the Company's management and executives that is designed to reward focus on increasing throughputs, reducing costs, and increasing efficiencies. The 2005 Key Associate and Management Equity Incentive Plan, which is administered by the Committee, gives the Company flexibility to provide incentives that are comparable to those found in the marketplace in which the Company competes for management and associate talent. In determining the extend and nature of awards, the Committee considers the Company's cash flow, net income, progress toward short-term and long-term business objectives, and other competitive compensation programs.

### **2006 Executive Compensation Components**

For the fiscal year ended December 31, 2006, 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 compensation, the Committee considered:

- The Company's financial performance and peer group compensation data; and
- CEO leadership, decision-making skills, experience, knowledge, communication with the Board of Directors and strategic recommendations, as well as the Company's positioning for future performance.



















