

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 28, 2013

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File No. 0-19621

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.

(Exact name of registrant as specified in its charter)

Minnesota
(State or other jurisdiction of
incorporation or organization)

41-1454591
(I.R.S. Employer
Identification No.)

7400 Excelsior Boulevard, Minneapolis, Minnesota
(Address of principal executive offices)

55426-4517
(Zip Code)

952-930-9000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
 Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

As of November 7, 2013, there were outstanding 5,570,927 shares of the registrant's Common Stock, without par value.

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.
CONSOLIDATED BALANCE SHEETS
(In Thousands)

	September 28, 2013	December 29, 2012
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,131	\$ 3,174
Accounts receivable, net of allowance of \$10 and \$8, respectively	10,796	6,256
Inventories, net of reserves of \$149 and \$682, respectively	15,249	17,274
Income taxes receivable	263	522
Other current assets	1,473	1,332
Total current assets	29,912	28,558
Property and equipment, net	11,686	12,248
Restricted cash	500	—
Other assets	976	973
Deferred income taxes	24	25
Total assets (a)	\$ 43,098	\$ 41,804
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 7,277	\$ 4,957
Accrued expenses	5,328	4,310
Line of credit	6,823	10,559
Current maturities of long-term obligations	1,217	955
Income taxes payable	229	—
Deferred income tax liabilities	146	146
Total current liabilities	21,020	20,927
Long-term obligations, less current maturities	5,706	6,357
Deferred gain, net of current portion	—	365
Deferred income tax liabilities	921	921
Total liabilities (a)	27,647	28,570
Commitments and contingencies		
Shareholders' equity:		
Common Stock, no par value; 10,000 shares authorized; issued and outstanding: 5,571 shares and 5,556 shares, respectively	20,773	20,577
Accumulated deficit	(6,563)	(8,649)
Accumulated other comprehensive loss	(386)	(290)
Total shareholders' equity	13,824	11,638
Noncontrolling interest	1,627	1,596
	15,451	13,234
Total liabilities and shareholders' equity	\$ 43,098	\$ 41,804

(a) Assets of ARCA Advanced Processing, LLC (AAP), our consolidated variable interest entity (VIE), that can only be used to settle obligations of AAP were \$9,856 and \$10,045 as of September 28, 2013, and December 29, 2012, respectively. Liabilities of AAP for which creditors do not have recourse to the general credit of Appliance Recycling Centers of America, Inc. were \$2,140 and \$1,948 as of September 28, 2013, and December 29, 2012, respectively.

See Notes to Consolidated Financial Statements.

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In Thousands, Except Per Share Amounts)

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Revenues:				
Retail	\$ 17,018	\$ 17,286	\$ 52,878	\$ 56,006
Recycling	11,823	7,025	30,383	18,435
Byproduct	4,697	4,417	12,974	13,274
Total revenues	33,538	28,728	96,235	87,715
Costs of revenues	24,445	21,634	70,737	64,740
Gross profit	9,093	7,094	25,498	22,975
Selling, general and administrative expenses	7,291	7,828	22,071	23,818
Operating income (loss)	1,802	(734)	3,427	(843)
Other expense:				
Interest expense, net	(320)	(299)	(925)	(832)
Other expense, net	7	(13)	(13)	(22)
Income (loss) before income taxes and noncontrolling interest	1,489	(1,046)	2,489	(1,697)
Provision for income taxes	227	113	372	90
Net income (loss)	1,262	(1,159)	2,117	(1,787)
Net loss (income) attributable to noncontrolling interest	(128)	77	(31)	(2)
Net income (loss) attributable to controlling interest	<u>\$ 1,134</u>	<u>\$ (1,082)</u>	<u>\$ 2,086</u>	<u>\$ (1,789)</u>
Income (loss) per common share:				
Basic	\$ 0.20	\$ (0.19)	\$ 0.38	\$ (0.32)
Diluted	<u>\$ 0.20</u>	<u>\$ (0.19)</u>	<u>\$ 0.36</u>	<u>\$ (0.32)</u>
Weighted average common shares outstanding:				
Basic	5,564	5,556	5,559	5,549
Diluted	<u>5,777</u>	<u>5,556</u>	<u>5,723</u>	<u>5,549</u>
Net income (loss)	\$ 1,262	\$ (1,159)	\$ 2,117	\$ (1,787)
Other comprehensive income (loss), net of tax:				
Effect of foreign currency translation adjustments	40	120	(96)	109
Total other comprehensive income (loss), net of tax	40	120	(96)	109
Comprehensive income (loss)	1,302	(1,039)	2,021	(1,678)
Comprehensive loss (income) attributable to noncontrolling interest	(128)	77	(31)	(2)
Comprehensive income (loss) attributable to controlling interest	<u>\$ 1,174</u>	<u>\$ (962)</u>	<u>\$ 1,990</u>	<u>\$ (1,680)</u>

See Notes to Consolidated Financial Statements.

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Nine Months Ended	
	September 28, 2013	September 29, 2012
Operating activities		
Net income (loss)	\$ 2,117	\$ (1,787)
Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	1,017	907
Share-based compensation	160	130
Amortization of deferred gain	(365)	(366)
Amortization of debt issuance costs	105	148
Valuation allowance against deferred tax assets	—	113
Other	16	35
Changes in assets and liabilities:		
Accounts receivable	(4,541)	132
Inventories	2,025	(2,060)
Other current assets	118	(735)
Other assets	(38)	(38)
Accounts payable and accrued expenses	3,353	1,427
Income taxes payable	229	—
Net cash flows provided by (used in) operating activities	4,196	(2,094)
Investing activities		
Purchases of property and equipment	(357)	(742)
Increase in restricted cash	(500)	—
Proceeds from sale of property and equipment	10	—
Net cash flows used in investing activities	(847)	(742)
Financing activities		
Net borrowings (payments) under line of credit	(3,736)	1,772
Payments on debt obligations	(687)	(748)
Proceeds from issuance of debt obligations	220	—
Proceeds from issuance of Common Stock	36	86
Payment of debt issuance costs	(129)	—
Net cash flows provided by (used in) financing activities	(4,296)	1,110
Effect of changes in exchange rate on cash and cash equivalents	(96)	102
Decrease in cash and cash equivalents	(1,043)	(1,624)
Cash and cash equivalents at beginning of period	3,174	4,401
Cash and cash equivalents at end of period	\$ 2,131	\$ 2,777

See Notes to Consolidated Financial Statements.

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(In Thousands)

	Nine Months Ended	
	September 28, 2013	September 29, 2012
Supplemental disclosures of cash flow information		
Cash payments for interest	\$ 712	\$ 680
Cash payments for income taxes, net of refunds	\$ (110)	\$ 123
Non-cash investing and financing activities		
Equipment acquired under capital lease and other financing obligations	\$ 78	\$ 159
Repayment of debt from trade-in of equipment	\$ —	\$ 87

See Notes to Consolidated Financial Statements.

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(In Thousands, Except Per Share Amounts)

1. Nature of Business and Basis of Presentation

Appliance Recycling Centers of America, Inc. and subsidiaries (“we,” the “Company” or “ARCA”) are in the business of providing turnkey appliance recycling and replacement services for electric utilities and other sponsors of energy efficiency programs. We also sell new major household appliances through a chain of Company-owned stores under the name ApplianceSmart®. In addition, we have a 50% interest in a joint venture operating under the name ARCA Advanced Processing, LLC (“AAP”), which recycles appliances from twelve states in the Northeast and Mid-Atlantic regions of the United States for General Electric Company (“GE”) acting through its GE Appliances business component. These appliances include units manufactured by GE as well as by other manufacturers.

The accompanying consolidated financial statements of the Company are unaudited and have been prepared in accordance with generally accepted accounting principles (“GAAP”) in the United States of America for interim financial information and Article 8 of Regulation S-X promulgated by the United States Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, normal and recurring adjustments and accruals considered necessary for a fair presentation for the periods indicated have been included. Operating results for the three-month and nine-month periods ended September 28, 2013, and September 29, 2012, are presented using 13-week and 39-week periods, respectively. The results of operations for any interim period are not necessarily indicative of the results for the year.

These financial statements should be read in conjunction with the Company’s audited consolidated financial statements and related notes thereto for the year ended December 29, 2012, included in the Company’s Annual Report on Form 10-K filed with the SEC on March 22, 2013.

Principles of consolidation: The consolidated financial statements include the accounts of Appliance Recycling Centers of America, Inc. and our subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

ApplianceSmart, Inc., a Minnesota corporation, is a wholly owned subsidiary that was formed through a corporate reorganization in July 2011 to hold our business of selling new major household appliances through a chain of Company-owned retail stores. ARCA Canada Inc., a Canadian corporation, is a wholly owned subsidiary that was formed in September 2006 to provide turnkey recycling services for electric utility energy efficiency programs. ARCA Recycling, Inc., a California corporation, is a wholly owned subsidiary that was formed in November 1991 to provide turnkey recycling services for electric utility efficiency programs. The operating results of our wholly owned subsidiaries are consolidated in our financial statements.

AAP is a joint venture that was formed in October 2009 between ARCA and 4301 Operations, LLC (“4301”) to support ARCA’s agreement, as amended, with GE acting through its GE Appliances business component. Both ARCA and 4301 have a 50% interest in AAP. GE sells its recyclable appliances generated from twelve states in the Northeast and Mid-Atlantic regions of the United States to ARCA, which collects, processes and recycles the appliances. The agreement requires that ARCA will only recycle, and will not sell for re-use or resale, the recyclable appliances purchased from GE. AAP established a regional processing center in Philadelphia, Pennsylvania, at which the recyclable appliances are processed. The term of the agreement is for six years from the first date of appliance collection, which was March 31, 2010. AAP commenced operations in February 2010 and has the exclusive rights to service the GE agreement as a subcontractor for ARCA. The financial position and results of operations of AAP are consolidated in our financial statements based on our conclusion that AAP is a variable interest entity and because we have the ability to significantly influence the economic performance of the entity through our contractual agreement with GE.

Reclassifications: The consolidated statements of comprehensive income (loss) include the reclassification of prior year revenues, cost of revenues and sales, general and administrative expenses related to AAP to conform with the current year presentation. The reclassification is related primarily to facilities costs and certain other costs not directly related to the production of recycled materials from cost of revenues to sales, general and administrative expenses.

Fair value of financial instruments: The following methods and assumptions are used to estimate the fair value of each class of financial instrument:

Cash and cash equivalents, accounts receivable and accounts payable: Due to their nature and short-term maturities, the carrying amounts approximate fair value.

Short- and long-term debt: The fair value of short- and long-term debt approximates carrying value and has been estimated based on discounted cash flows using interest rates being offered for similar debt having the same or similar remaining maturities and collateral requirements.

No separate comparison of fair values versus carrying values is presented for the aforementioned financial instruments since their fair values are not significantly different than their balance sheet carrying amounts. In addition, the aggregate fair values of the financial instruments would not represent the underlying value of our Company.

2. Significant Accounting Policies

Trade receivables: We carry unsecured trade receivables at the original invoice amount less an estimate made for doubtful accounts based on a monthly review of all outstanding amounts. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history and current economic conditions. We write off trade receivables when we deem them uncollectible. We record recoveries of trade receivables previously written off when we receive them. We consider a trade receivable to be past due if any portion of the receivable balance is outstanding for more than ninety days. We do not charge interest on past due receivables. Our management considers the allowance for doubtful accounts of \$10 and \$8 to be adequate to cover any exposure to loss at September 28, 2013, and December 29, 2012, respectively.

Inventories: Inventories, consisting principally of appliances, are stated at the lower of cost, determined on a specific identification basis, or market and consist of:

	September 28, 2013	December 29, 2012
Appliances held for resale	\$ 15,112	\$ 17,768
Processed metals from recycled appliances held for resale	286	188
Less provision for inventory obsolescence	(149)	(682)
	<u>\$ 15,249</u>	<u>\$ 17,274</u>

We provide estimated provisions for the obsolescence of our appliance inventories, including adjustments to market, based on various factors, including the age of such inventory and our management's assessment of the need for such provisions. We look at historical inventory agings and margin analysis in determining our provision estimate. A revised cost basis is used once a provision for obsolescence is recorded.

Property and equipment: Property and equipment consists of the following:

	September 28, 2013	December 29, 2012
Land	\$ 1,140	\$ 1,140
Buildings and improvements	3,275	3,429
Equipment (including computer software)	20,539	20,158
Projects under construction	62	63
	<u>25,016</u>	<u>24,790</u>
Less accumulated depreciation and amortization	(13,330)	(12,542)
	<u>\$ 11,686</u>	<u>\$ 12,248</u>

Software development costs: We capitalize software developed for internal use and are amortizing such costs over their estimated useful lives of three years. Costs capitalized were \$20 and \$30 for the three months ended September 28, 2013, and September 29, 2012, respectively. Costs capitalized were \$83 and \$115 for the nine months ended September 28, 2013, and September 29, 2012, respectively.

Restricted cash: Restricted cash consisted of a reserve required by our bankcard processor to cover chargebacks, adjustments, fees and other charges that may be due from us.

Product warranty: We provide a warranty for the replacement or repair of certain defective units, which varies based on the product sold. Our standard warranty policy requires us to repair or replace certain defective units at no cost to our customers. We estimate the costs that may be incurred under our warranty and record an accrual in the amount of such costs at the time we recognize product revenue. Factors that affect our warranty accrual for covered units include the number of units sold, historical and anticipated rates of warranty claims on these units, and the cost of such claims. We periodically assess the adequacy of our recorded warranty accrual and adjust the amounts as necessary.

Changes in our warranty accrual are as follows:

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Beginning Balance	\$ 41	\$ 61	\$ 47	\$ 71
Standard accrual based on units sold	(4)	10	(12)	34
Actual costs incurred	10	(4)	36	(12)
Periodic accrual adjustments	(8)	(12)	(32)	(38)
Ending Balance	\$ 39	\$ 55	\$ 39	\$ 55

Share-based compensation: We recognize share-based compensation expense on a straight-line basis over the expected vesting period for share-based awards granted. We use the Black-Scholes option pricing model to determine the fair value of awards at the grant date. We calculate the expected volatility for stock awards using historical volatility. We estimate a 0%-5% forfeiture rate for stock awards issued to all employees and members of the Board of Directors, but will continue to review these estimates in future periods. The risk-free rates for the expected terms of the stock awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life represents the period that the stock awards are expected to be outstanding. The expected dividend yield is zero as we have not paid or declared any cash dividends on our Common Stock. Based on these valuations, we recognized share-based compensation expense of \$101 and \$62 for the three months ended September 28, 2013, and September 29, 2012, respectively, and \$160 and \$130 for the nine months ended September 28, 2013 and September 29, 2012, respectively. We estimate that the remaining expense for fiscal 2013, 2014, 2015 and 2016 will be approximately \$73, \$159, \$97, and \$19, respectively, based on the value of stock option awards outstanding as of September 28, 2013. This estimate does not include any expense for additional awards that may be granted and vest during fiscal 2013.

Comprehensive income (loss): Other comprehensive income (loss) refers to revenues, expenses, gains and losses that under generally accepted accounting principles are included in comprehensive income (loss) but are excluded from net income (loss) as these amounts are recorded directly as an adjustment to shareholders' equity. Our other comprehensive income (loss) is comprised of foreign currency translation adjustments.

Basic and diluted income (loss) per share: Basic income (loss) per common share is computed based on the weighted average number of common shares outstanding. Diluted income (loss) per common share is computed based on the weighted average number of common shares outstanding adjusted by the number of additional shares that would have been outstanding had the potentially dilutive common shares been issued. Potentially dilutive shares of Common Stock include unexercised stock options and warrants. Basic per share amounts are computed, generally, by dividing net income (loss) attributable to controlling interest by the weighted average number of common shares outstanding. Diluted per share amounts assume the conversion, exercise or issuance of all potential Common Stock instruments unless their effect is anti-dilutive, thereby reducing the loss or increasing the income per common share. In calculating diluted weighted average shares and per share amounts, we included stock options and warrants with exercise prices below average market prices, for the respective reporting periods in which they were dilutive, using the treasury stock method. We calculated the number of additional shares by assuming the outstanding stock options were exercised and that the proceeds from such exercises were used to acquire Common Stock at the average market price during the quarter. For the three and nine months ended September 28, 2013, we excluded 364 and 465, respectively, options and warrants from the diluted weighted average share outstanding calculation as the effect of these options and warrants were anti-dilutive. For the three and nine months ended September 29, 2012, we excluded 816 and 798, respectively, options and warrants from the diluted weighted average shares outstanding calculation as the effect of these options were anti-dilutive due to the net loss incurred.

A reconciliation of the denominator in the basic and diluted income or loss per share is as follows:

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Numerator:				
Net income (loss) attributable to controlling interest	\$ 1,134	\$ (1,082)	\$ 2,086	\$ (1,789)
Denominator:				
Weighted average shares outstanding — basic	5,564	5,556	5,559	5,549
Employee stock options	27	—	3	—
Stock warrants	186	—	161	—
Weighted average shares outstanding — diluted	5,777	5,556	5,723	5,549
Income (loss) per share:				
Basic	\$ 0.20	\$ (0.19)	\$ 0.38	\$ (0.32)
Diluted	\$ 0.20	\$ (0.19)	\$ 0.36	\$ (0.32)

3. Variable Interest Entity

The financial position and results of operations of AAP are consolidated in our financial statements based on our conclusion that AAP is a variable interest entity and because we have the ability to significantly influence the economic performance of the entity through our contractual agreement with GE.

The following table summarizes the assets and liabilities of AAP as of September 28, 2013, and December 29, 2012:

	September 28, 2013	December 29, 2012
Assets		
Current assets	\$ 848	\$ 787
Property and equipment, net	8,868	9,109
Other assets	140	149
Total Assets	\$ 9,856	\$ 10,045
Liabilities		
Accounts payable	\$ 1,019	\$ 826
Accrued expenses	258	204
Current maturities of long-term debt obligations	885	635
Long-term debt obligations, net of current maturities	3,969	4,437
Other liabilities (a)	469	749
Total Liabilities	\$ 6,600	\$ 6,851

(a) Other liabilities represent loans between ARCA and AAP that are eliminated in consolidation.

The following table summarizes the operating results of AAP for the three and nine months ended September 28, 2013, and September 29, 2012:

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Revenues	\$ 3,037	\$ 2,468	\$ 8,281	\$ 8,114
Gross profit	819	115	1,569	1,364
Operating income (loss)	331	(71)	272	258
Net income (loss)	255	(153)	62	4

4. Other Assets

Other assets as of September 28, 2013, and December 29, 2012, consist of the following:

	September 28, 2013	December 29, 2012
Goodwill	\$ 38	\$ 38
Deposits	413	376
Recycling contract, net	200	259
Debt issuance costs, net	304	279
Patent costs	21	21
	<u>\$ 976</u>	<u>\$ 973</u>

For the three and nine months ended September 28, 2013, and September 29, 2012, we recorded amortization expense of \$20 and \$60, respectively, related to our recycling contract. For the three months ended September 28, 2013, and September 29, 2012, we recorded non-cash interest expense of \$28 and \$49, respectively, related to debt issuance costs. For the nine months ended September 28, 2013, and September 29, 2012, we recorded non-cash interest expense of \$105 and \$148, respectively, related to debt issuance costs. In connection with the third amendment to our Credit Agreement with PNC Bank, N.A. ("PNC") executed on March 14, 2013, we incurred additional debt issuance costs of \$129. The additional debt issuance costs were capitalized and will be amortized over the remaining term of the Credit Agreement along with the remaining balance of the previously capitalized costs. See Note 6 for further discussion regarding the amended Credit Agreement entered into with PNC.

5. Accrued Expenses

Accrued expenses as of September 28, 2013, and December 29, 2012, consist of the following:

	September 28, 2013	December 29, 2012
Compensation and benefits	\$ 1,524	\$ 963
Accrued incentive and rebate checks	495	563
Accrued rent	1,182	1,383
Warranty expense	39	47
Accrued payables	425	307
Current portion of deferred gain on sale-leaseback of building	487	487
Deferred revenue	231	157
Other	945	403
	<u>\$ 5,328</u>	<u>\$ 4,310</u>

6. Line of Credit

On January 24, 2011, we entered into a Revolving Credit, Term Loan and Security Agreement, as amended, ("Credit Agreement") with PNC Bank, National Association ("PNC") that provides us with a \$15,000 revolving line of credit. See Note 8 for further discussion regarding the Term Loan entered into with PNC. The Credit Agreement has a stated maturity date of January 24, 2016, if not renewed. The Credit Agreement includes a lockbox agreement and a subjective acceleration clause and as a result we have classified the revolving line of credit as a current liability. The Credit Agreement is collateralized by a security interest in substantially all of our assets and PNC is also secured by an inventory repurchase agreement with Whirlpool Corporation for Whirlpool purchases only. We also issued a \$750 letter of credit in favor of Whirlpool Corporation. The Credit Agreement requires starting with the fiscal quarter ending December 28, 2013, and continuing at the end of each quarter thereafter, that we meet a minimum fixed charge coverage ratio of 1.10 to 1.00, measured on a trailing twelve-month basis. The Credit Agreement limits investments we can purchase, the amount of other debt and leases we can incur, the amount of loans we can issue to our affiliates and the amount we can spend on fixed assets, along with prohibiting the payment of dividends. The interest rate on the revolving line of credit is PNC Base Rate plus 2.75%. If certain interest rate reduction conditions are met starting January 31, 2014, the rate will change to PNC Base Rate plus 1.75%, or 1-, 2- or 3-month PNC LIBOR Rate plus 2.75%. The PNC Base Rate shall mean,

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for any day, a fluctuating per annum rate of interest equal to the highest of (i) the interest rate per annum announced from time to time by PNC at its prime rate, (ii) the Federal Funds Open Rate plus 0.5%, and (iii) the one-month LIBOR rate plus 100 basis points (1%). As of September 28, 2013, the outstanding balance under the Credit Agreement was \$6,823 with an interest rate of 6.00%. As of December 29, 2012, the outstanding balance under the Credit Agreement was \$10,559 with a weighted average interest rate of 3.07%, which included both PNC LIBOR Rate and PNC Base Rate loans. The amount of revolving borrowings under the Credit Agreement is based on a formula using accounts receivable and inventories. We may not have access to the full \$15,000 revolving line of credit due to the formula using accounts receivable and inventories, the amount of the letter of credit issued in favor of Whirlpool Corporation and the amount of outstanding loans between PNC and our AAP joint venture. As of September 28, 2013, and December 29, 2012, our available borrowing capacity under the Credit Agreement was \$6,801 and \$2,531, respectively.

On March 14, 2013, we executed the third amendment to the Credit Agreement that extended the agreement from January 24, 2014, until January 24, 2016, waived our prior "events of default," reset our financial covenants and increased our interest rate, among other things. The material amended terms under the Credit Agreement are as follows:

- We must meet monthly minimum EBITDA requirements set forth in the amendment through 2013.
- The affiliate loan balance must be reduced by \$40 per month in 2013 and the affiliate loan balance will be capped at \$300 on January 25, 2014, and thereafter.
- Starting on December 28, 2013, we must meet a minimum fixed charge coverage ratio of 1.10 to 1.00 for the nine months then ended and on a trailing twelve-month basis beginning with the period ending March 30, 2014, and each quarter thereafter.
- The interest rate spread on our Revolving Loan and Term Loan increased 100 basis points for both PNC Base Rate loans and 1-, 2- or 3-month PNC LIBOR Rate loans. We are not eligible to borrow under 1-, 2- or 3-month PNC LIBOR Rate loans until certain interest rate reduction conditions are met as set forth in the amendment, which include meeting all financial covenants during 2013. If these interest rate reduction conditions are met, we will also be able to remove the 100 basis point increase for both PNC Base Rate loans and 1-, 2- or 3-month PNC LIBOR Rate loans. The earliest the interest rate reduction conditions could be met is January 31, 2014.
- A prepayment penalty will be assessed at 3% during the first year of the third amendment to our Credit Agreement, 2% during the second year and 1% during the third year.

On September 27, 2013, we executed the fourth amendment to the Credit Agreement. The material amended terms under the Credit Agreement are as follows:

- The affiliate loan balance be held at \$469.1 until January 24, 2014, and starting in January 2014 and each month thereafter the affiliate loan balance must be reduced by \$14 per month until December 31, 2014. The affiliate loan balance will be capped at \$300 on December 31, 2014, and thereafter.
- We will be eligible to borrow under 1-, 2- or 3-month PNC LIBOR Rate loans on November 1, 2013, if ARCA and AAP receive at least \$300 in cash related to selling carbon offsets. On October 9, 2013, the combination of ARCA and AAP received \$516 in cash related to selling carbon offsets.

7. Deferred Gain

In connection with the September 25, 2009, sale-leaseback of our St. Louis Park, Minnesota, building, we recorded a deferred gain of \$2,436. The deferred gain is being amortized over the initial lease period of five years. For both the three months ended September 28, 2013, and September 29, 2012, we amortized \$122 of the deferred gain. For the nine months ended September 28, 2013, and September 29, 2012, we amortized \$365 and \$366, respectively, of the deferred gain. The deferred gain amortization is netted against rent expense as a component of selling, general and administrative expenses in the consolidated statements of comprehensive income (loss).

8. Borrowings

Long-term debt, capital lease and other financing obligations as of September 28, 2013, and December 29, 2012, consist of the following:

	September 28, 2013	December 29, 2012
PNC term loan	\$ 1,849	\$ 2,040
Floating rate term loans, due in monthly installments of \$54, including interest, due March 2021, collateralized by equipment	3,886	4,154
2.75% note, due in monthly installments of \$3, including interest, due October 2024, collateralized by equipment	389	411
10.00% note, due in monthly installments of \$13, including interest, due December 2014	181	280
Capital leases and other financing obligations	618	427
	6,923	7,312
Less current maturities	1,217	955
	<u>\$ 5,706</u>	<u>\$ 6,357</u>

On January 24, 2011, we entered into a \$2,550 Term Loan (“Term Loan”) with PNC Bank to refinance the mortgage on our California facility. The Term Loan is payable as follows, subject to acceleration upon the occurrence of an event of default or termination of the Revolving Credit Agreement: 119 consecutive monthly principal payments of \$21 plus interest commencing on February 1, 2011, and continuing on the first day of each month thereafter followed by a 120th payment of all unpaid principal, interest and fees on February 1, 2021. If the Revolving Credit Agreement is not renewed, a balloon payment of \$1,275 in principal plus interest and additional fees will be due on January 24, 2016. The Term Loan is collateralized with our California facility located in Compton, California. The interest rate is PNC Base Rate plus 3.25%. If certain interest rate reduction conditions are met starting January 31, 2014, the rate will change to PNC Base Rate plus 2.25%, or 1-, 2- or 3-month PNC LIBOR Rate plus 3.25%. As of September 28, 2013, and December 29, 2012, the interest rate was 6.50% and 5.50%, respectively.

On March 10, 2011, ARCA Advanced Processing, LLC entered into three separate commercial term loans (“AAP Term Loans”) with Susquehanna Bank, pursuant to the guidelines of the U.S. Small Business Administration 7(a) Loan Program. The total amount of the AAP Term Loans is \$4,750, split into three separate loans for \$2,100; \$1,400; and \$1,250. The AAP Term Loans mature in ten years and bear an interest rate of Prime plus 2.75%. As of September 28, 2013, and December 29, 2012, the interest rate was 6.00%. Borrowings under the AAP Term Loans are secured by substantially all of the assets of AAP along with liens on the business assets and certain personal assets of the owners of 4301 Operations, LLC. We are a guarantor of the AAP Term Loans along with 4301 Operations, LLC and its owners.

Capital leases and other financing obligations: We acquire certain equipment under capital leases and other financing obligations. The cost of the equipment was approximately \$2,031 and \$1,969 at September 28, 2013, and December 29, 2012, respectively. Accumulated amortization at September 28, 2013, and December 29, 2012, was approximately \$1,620 and \$1,574, respectively. Depreciation and amortization expense is included in cost of revenues and selling, general and administrative expenses.

9. Commitments and Contingencies

Contracts: We have entered into material contracts with three appliance manufacturers. Under the agreements there are no minimum purchase commitments; however, we have agreed to indemnify the manufacturers for certain claims, allegations or losses with respect to appliances we sell.

Litigation: We are party from time to time to ordinary course disputes that we do not believe to be material or have merit. We intend to vigorously defend ourselves against these ordinary course disputes.

10. Income Taxes

For the three and nine months ended September 28, 2013, we recorded a provision for income taxes of \$227 and \$372, respectively. For the three and nine months ended September 29, 2012, we recorded a provision for income taxes of \$113 and \$90, respectively. We have available net operating losses to utilize in 2013 to offset a portion of our projected full-year taxable income for the United States. We also expect to receive \$250 carryback refund in 2013 related to taxable losses incurred in 2012. We expect to realize a Canadian tax benefit in fiscal 2013 as a result of carrying back the fiscal 2013 Canadian losses. We regularly evaluate both positive and negative evidence related to retaining a valuation allowance against our deferred tax assets. The realization of deferred tax assets is dependent upon sufficient future taxable income during the periods when deductible temporary differences and carryforwards are expected to be available to reduce taxable income. We have concluded based on the weight of negative evidence

that a valuation allowance should be maintained against our deferred tax assets that we do not expect to utilize as of September 28, 2013.

We recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the consolidated financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. As of September 28, 2013, and December 29, 2012, we did not have any material uncertain tax positions.

It is our practice to recognize interest related to income tax matters as a component of interest expense and penalties as a component of selling, general and administrative expense. As of September 28, 2013, and December 29, 2012, we had an immaterial amount of accrued interest and penalties.

We are subject to income taxes in the U.S. federal jurisdiction, foreign jurisdictions and various state jurisdictions. Tax regulations from each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. With few exceptions, we are no longer subject to U.S. federal, foreign, state or local income tax examinations by tax authorities for the years before 2010. We are not currently under examination by any taxing jurisdiction.

We had no significant unrecognized tax benefits as of September 28, 2013, and December 29, 2012, that would reasonably be expected to affect our effective tax rate during the next twelve months.

11. Shareholders' Equity

Stock options: On May 12, 2011, our shareholders approved and adopted the 2011 Stock Compensation Plan (the "2011 Plan"). The 2011 Plan authorizes the granting of awards in any of the following forms: (i) stock options, (ii) stock appreciation rights, and (iii) other share-based awards, including but not limited to restricted stock, restricted stock units or performance shares and expires on the earlier of May 12, 2021, or the date that all shares reserved under the 2011 Plan are issued or no longer available.

The 2011 Plan provides for the issuance of up to 700 shares of Common Stock pursuant to awards granted under the 2011 Plan. Options granted to employees typically vest over two years while grants to non-employee directors vest in six months. As of September 28, 2013, 367 options were outstanding under the 2011 Plan. Our 2006 Stock Option Plan (the "2006 Plan") expired on June 30, 2011, but the options outstanding under the 2006 Plan continue to be exercisable in accordance with their terms. As of September 28, 2013, 391 options were outstanding under the 2006 Plan. Our Restated 1997 Stock Option Plan (the "1997 Plan") has expired, but the options outstanding under the expired 1997 Plan continue to be exercisable in accordance with their terms. As of September 28, 2013, options to purchase an aggregate of 8 shares were outstanding under the 1997 Plan.

On May 9, 2013, we granted 30 stock options from our 2011 Plan to non-employee directors with an exercise price of \$1.89 per share, a vesting period of six months and a weighted average fair value of \$1.66 per share. Also on May 9, 2013, we granted 185 stock options from our 2011 Plan to management with an exercise price of \$1.89 per share and a weighted average fair value of \$1.47 per share. The stock options granted to management have both time and performance vesting, of which 135 stock options vest equally over two years and 50 stock options vest based on the achievement of performance targets. For performance-based options, the Company evaluates the likelihood of the targets being met and records the expense over the probable vesting period.

On July 22, 2013, we granted 100 stock options from our 2011 Plan to management with an exercise price of \$2.65 per share and a weighted average fair value of \$2.06 per share. The stock options granted to management have both time and performance vesting, of which 50 stock options vest equally over 3 years and 50 stock options vest based on the achievement of performance targets. For performance-based options, the Company evaluates the likelihood of the targets being met and records the expense over the probable vesting period.

The following table summarizes the weighted-average assumptions used to estimate the fair value of stock options granted using the Black-Scholes Model:

	May 9, 2013	July 22, 2013
Expected dividend yield	—	—
Expected stock price volatility	90.93 %	89.60 %
Risk-free interest rate	1.28 %	1.88 %
Expected life of options	7.42	7.00

Stock warrants: As of September 28, 2013, we had 278 warrants outstanding that were fully vested and have exercise prices ranging from \$0.73 per share to \$3.55 per share, which begin to expire in October 2019.

Preferred Stock: Our amended Articles of Incorporation authorize two million shares of Preferred Stock that may be issued from time to time in one or more series having such rights, powers, preferences and designations as the Board of Directors may determine. To date no such preferred shares have been issued.

12. Segment Information

We operate within targeted markets through two reportable segments: retail and recycling. The retail segment is comprised of income generated through our ApplianceSmart stores, which includes appliance sales and byproduct revenues from collected appliances. The recycling segment includes all fees charged and costs incurred for collecting, recycling and installing appliances for utilities and other customers and includes byproduct revenue, which is primarily generated through the recycling of appliances. We have included the results from consolidating AAP in our recycling segment. The nature of products, services and customers for both segments varies significantly. As such, the segments are managed separately. Our Chief Executive Officer has been identified as the Chief Operating Decision Maker (“CODM”). The CODM evaluates performance and allocates resources based on revenues and income from operations of each segment. Income from operations represents revenues less cost of revenues and operating expenses, including certain allocated selling, general and administrative costs. There are no inter-segment sales or transfers.

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The following tables present our segment information for periods indicated:

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Revenues:				
Retail	\$ 17,300	\$ 17,572	\$ 53,732	\$ 56,915
Recycling	16,238	11,156	42,503	30,800
Total revenues	<u>\$ 33,538</u>	<u>\$ 28,728</u>	<u>\$ 96,235</u>	<u>\$ 87,715</u>
Operating income (loss):				
Retail	\$ (163)	\$ (961)	\$ (216)	\$ (1,419)
Recycling	2,172	194	4,193	595
Unallocated corporate	(207)	33	(550)	(19)
Total operating income (loss)	<u>\$ 1,802</u>	<u>\$ (734)</u>	<u>\$ 3,427</u>	<u>\$ (843)</u>
Assets:				
Retail	\$ 15,675	\$ 21,588	\$ 15,675	\$ 21,588
Recycling	22,904	20,319	22,904	20,319
Corporate assets not allocable	4,519	5,700	4,519	5,700
Total assets	<u>\$ 43,098</u>	<u>\$ 47,607</u>	<u>\$ 43,098</u>	<u>\$ 47,607</u>
Cash capital expenditures:				
Retail	\$ 5	\$ 52	\$ 11	\$ 222
Recycling	244	30	256	232
Corporate assets not allocable	5	35	90	288
Total cash capital expenditures	<u>\$ 254</u>	<u>\$ 117</u>	<u>\$ 357</u>	<u>\$ 742</u>
Depreciation and amortization:				
Retail	\$ 45	\$ 58	\$ 146	\$ 170
Recycling	203	145	598	444
Unallocated corporate	89	95	273	293
Total depreciation and amortization	<u>\$ 337</u>	<u>\$ 298</u>	<u>\$ 1,017</u>	<u>\$ 907</u>
Interest expense:				
Retail	\$ 134	\$ 105	\$ 380	\$ 284
Recycling	115	115	321	354
Unallocated corporate	72	81	226	198
Total interest expense	<u>\$ 321</u>	<u>\$ 301</u>	<u>\$ 927</u>	<u>\$ 836</u>

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking and Cautionary Statements

This quarterly report contains statements that are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Act of 1934, as amended. Any statements contained in this quarterly report that are not purely historical or relate to our future operations, performance and results, and anticipated liquidity are forward looking. These forward-looking statements are based on information available to us on the date of this quarterly report, but are subject to risks and uncertainties, including, but not limited to, those discussed herein. Our actual results could differ materially from those discussed in this quarterly report.

The forward-looking statements contained in this quarterly report, and other written and oral forward-looking statements made by us from time to time, are subject to risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Any forward-looking information regarding our operations will be affected primarily by individual retail stores' profitability, the volume of appliance sales, the strength of energy conservation recycling programs and general economic conditions affecting consumer demand for appliances. Any forward-looking information will also be affected by our continued ability to purchase product from our suppliers at acceptable prices, the ability of individual retail stores to meet planned revenue levels, the number of retail stores, costs and expenses being realized at higher than expected levels, our ability to secure an adequate supply of special-buy appliances for resale, the ability to secure appliance recycling and replacement contracts with sponsors of energy efficiency programs, the ability of customers to supply units under their recycling contracts with us, the performance of our consolidated variable interest entity and the continued availability of our current line of credit. Other factors that might cause such a difference include, but are not limited to, those discussed in Item 1A "Risk Factors" in our annual report on Form 10-K for the year ended December 29, 2012.

The following discussion and analysis provides information that we believe is relevant to an assessment and understanding of our operations and financial condition. This discussion should be read with the consolidated financial statements appearing in Item 1.

Overview

We operate two reportable segments: retail and recycling. Our retail segment is comprised of income generated from the sale of appliances through ApplianceSmart® stores and includes a small portion of our byproduct revenues from collected appliances. Our recycling segment includes all income generated from collecting, recycling and installing appliances for utilities and other customers and includes a significant portion of our byproduct revenue, which is primarily generated through the recycling of appliances. Our recycling segment also includes all income generated from our agreement with General Electric ("GE") acting through its GE Appliances business component. GE sells its recyclable appliances in certain regions of the United States to us and we collect, process and recycle the appliances. These appliances include units manufactured by GE as well as by other manufacturers. The agreement requires that we will only recycle, and will not sell for re-use or resale, the recyclable appliances purchased from GE. We have established regional processing centers in Philadelphia and Louisville to support our agreement with GE. The regional processing center in Philadelphia is operated by ARCA Advanced Processing, LLC ("AAP") through a joint venture agreement between ARCA and 4301 Operations, LLC ("4301").

Our business components are uniquely positioned in the industry to work together to provide a full array of appliance-related services. ApplianceSmart operates eighteen company-owned stores, sells new appliances directly to consumers and provides affordable ENERGY STAR® options for energy efficiency appliance replacement programs. Our eleven regional centers process appliances at end of life to remove environmentally damaging substances and produce material byproducts for recycling for over 150 utilities in the U.S. and Canada. AAP employs advanced technology to refine traditional appliance recycling techniques to achieve optimal revenue-generating and environmental benefits. We are also the exclusive North American distributor for UNTHA Recycling Technology ("URT"), one of the world's leading manufacturers of technologically advanced refrigerator recycling systems and recycling facilities for electrical household appliances and electronic scrap.

We believe the GE contract and AAP model are the future of appliance recycling and expect to open similar centers throughout the United States. We cannot predict when these centers may open or if the appropriate volumes can be obtained to support the AAP model at future locations.

Our retail segment is similar to many other retailers in that it is seasonal in nature. Historically, the fourth quarter is our weakest quarter in terms of both revenues and earnings. We believe this is primarily because the fourth quarter includes several holidays during which consumers tend to focus less on purchasing major household appliances.

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Revenues and earnings in our recycling segment are impacted by seasonal variances, with both the second and third quarters generally having higher levels of revenues and earnings. This seasonality is due primarily to our utility customers supporting more marketing and advertising during the spring and summer months. Our customers tend to promote the recycling programs more aggressively during the warmer months because they believe more people want to clean up their garages and basements during that time of the year. However, the addition of the GE agreement and some customers shifting to marketing their appliance recycling programs year-round has helped to mitigate some seasonality.

Our recycling segment typically operates two types of programs:

1. Fees charged for collecting and recycling appliances for utilities and other sponsors of energy efficiency programs.
2. Fees charged for recycling and replacing old appliances with new ENERGY STAR® appliances for energy efficiency programs sponsored by utilities.

Over the last twelve months recycling-only programs continue to report declining revenues and volumes, while we have experienced growing revenues and volumes from our replacement programs. We believe factors impacting this shift include a declining number of pre-1993 refrigerators eligible for recycling programs and a greater emphasis by utilities on promoting ENERGY STAR® appliances.

We derive revenues from the sale of carbon offsets created by the destruction of ozone-depleting CFCs generated at our ARCA and AAP recycling centers. Through the nine months ended September 28, 2013, we did not recognize any carbon offset revenues. After the third quarter ended, we and AAP collectively received \$0.5 million in cash related to the issuance and sale of carbon offset certificates in the California system. This sale will favorably impact fourth quarter earnings by the same amount. In 2012, we sold carbon offsets on the voluntary market and recognized \$0.1 million in revenues compared with \$1.2 million in 2011. We expect to create carbon offsets and derive revenues through California's market for the remainder of 2013 through 2014.

We monitor specific economic factors such as retail trends, consumer confidence, manufacturing by the major appliance companies, sales of existing homes and mortgage interest rates as key indicators of industry demand, particularly in our retail segment. Competition in the home appliance industry is intense in the four retail markets we serve. This includes competition not only from independent retailers, but also from such major retailers as Sears, Best Buy, The Home Depot and Lowe's. We also closely monitor the metals and various other scrap markets because of the type of components recovered in our recycling process. This includes monitoring the *American Metal Market* and the regions throughout the U.S. where we have our recycling centers.

Reporting Period. Operating results for the three and nine months ended September 28, 2013, and September 29, 2012, are presented using 13-week and 39-week periods, respectively. The results of operations for any interim period are not necessarily indicative of the results for the year.

Results of Operations

The following table sets forth our consolidated financial data as a percentage of total revenues for the three and nine months ended September 28, 2013, and September 29, 2012:

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Revenues:				
Retail	50.7 %	60.1 %	54.9 %	63.9 %
Recycling	35.3 %	24.5 %	31.6 %	21.0 %
Byproduct	14.0 %	15.4 %	13.5 %	15.1 %
Total revenues	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenues	72.9 %	75.3 %	73.5 %	73.8 %
Gross profit	27.1 %	24.7 %	26.5 %	26.2 %
Selling, general and administrative expenses	21.7 %	27.2 %	22.9 %	27.2 %
Operating income (loss)	5.4 %	(2.5)%	3.6 %	(1.0)%
Other income expense:				
Interest expense, net	(1.0)%	(1.0)%	(1.0)%	(0.9)%
Other expense, net	— %	— %	— %	— %
Income (loss) before income taxes and noncontrolling interest	4.4 %	(3.5)%	2.6 %	(1.9)%
Provision for (benefit of) income taxes	0.7 %	0.4 %	0.4 %	0.1 %
Net income (loss)	3.7 %	(3.9)%	2.2 %	(2.0)%
Net loss (income) attributable to noncontrolling interest	(0.4)%	0.3 %	— %	— %
Net income (loss) attributable to controlling interest	3.3 %	(3.6)%	2.2 %	(2.0)%

For the Three Months Ended September 28, 2013, and September 29, 2012

The following table sets forth the key results of operations by segment for the three months ended September 28, 2013, and September 29, 2012 (dollars in millions):

	Three Months Ended		
	September 28, 2013	September 29, 2012	% Change
Revenues:			
Retail	\$ 17.3	\$ 17.6	(2)%
Recycling	16.2	11.1	46 %
Total revenues	\$ 33.5	\$ 28.7	17 %
Operating income (loss):			
Retail	\$ (0.2)	\$ (0.9)	83 %
Recycling	2.2	0.2	1,020 %
Unallocated corporate costs	(0.2)	0.0	(727)%
Total operating income (loss)	1.8	(0.7)	346 %

Our total revenues of \$33.5 million for the third quarter of 2013 increased \$4.8 million, or 17%, from \$28.7 million in the third quarter of 2012. The increase in revenues was primarily attributed to our recycling segment. Replacement program revenues increased by \$5.2 million compared with the prior year, along with an increase in AAP revenues of \$0.6 million, which was partially offset by a decline in recycling-only revenues of \$0.4 million and a \$0.3 million decline in ApplianceSmart revenues. Retail segment revenues accounted for 52% of total revenues in the third quarter of 2013 compared with 56% in the same period of 2012.

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Recycling segment revenues and retail segment revenues each include a portion of byproduct revenues. In both the third quarter of 2013 and 2012, the recycling segment accounted for approximately 94% of the byproduct revenues. The increase in replacement program revenues impacted the overall mix of revenues between the retail and recycling segments for the third quarter of 2013 compared with same period of 2012. Future revenues and related earnings from appliance replacement programs, if any, are uncertain and may fluctuate significantly from year to year. Factors impacting future appliance replacement program revenues and earnings include the type and scope of energy efficiency programs approved by regulatory agencies, competitive bidding, contract changes, non-renewals and early cancellations.

Our total operating income of \$1.8 million for the third quarter of 2013 increased \$2.5 million compared with an operating loss of \$(0.7) million in the third quarter of 2012. The increase was related primarily to the increase in appliance replacement revenues, improved performance in the AAP joint venture and a reduction in retail store operating expenses and advertising.

Revenues. Revenues for the three months ended September 28, 2013, and September 29, 2012, were as follows (dollars in millions):

	Three Months Ended		
	September 28, 2013	September 29, 2012	% Change
Retail	\$ 17.0	\$ 17.3	(2)%
Recycling	11.8	7.0	68 %
Byproduct	4.7	4.4	6 %
	<u>\$ 33.5</u>	<u>\$ 28.7</u>	17 %

Retail Revenues. Our retail revenues of \$17.0 million for the third quarter of 2013 decreased \$0.3 million, or 2%, from \$17.3 million in the third quarter of 2012. The decrease in retail revenues was due primarily to the impact of closing three stores that were operating during the same period of 2012, which was partially offset by an increase in same-store sales. The store closures represented a \$1.1 million decline and same-store sales grew by \$0.8 million, or 4.8%. Our same-store sales includes contract sales, which increased to \$1.4 million compared with \$0.1 million in the same quarter of 2012.

Recycling Revenues. Our recycling revenues of \$11.8 million for the third quarter of 2013 increased \$4.8 million, or 68%, from \$7.0 million in the third quarter of 2012. Recycling revenues are comprised of two components: (1) appliance recycling revenues generated by collecting and recycling appliances for utilities and other sponsors of energy efficiency programs and (2) replacement program revenues generated by recycling and replacing old appliances with new energy efficient models for programs sponsored by utility companies. Appliance recycling revenues decreased 9% to \$3.7 million in the third quarter of 2013 compared with \$4.1 million in the third quarter of 2012, due primarily to lower volumes and price compression within certain contracts. The number of units driving our appliance recycling revenues declined 1% and the average revenue per unit declined by \$7 compared with the same quarter last year. Appliance replacement program revenues increased 180% to \$8.1 million in the third quarter of 2013 compared with \$2.9 million in the third quarter of 2012, due primarily to higher volumes and the mix of appliance replacements. Future revenues from appliance replacement programs, if any, are uncertain and may fluctuate significantly from period to period.

Byproduct Revenues. Our byproduct revenues of \$4.7 million for the third quarter of 2013 increased \$0.3 million, or 6%, from \$4.4 million in the third quarter of 2012. The increase in byproduct revenues was primarily the result of higher volumes processed by our AAP joint venture. Byproduct revenues include all of the revenues generated by AAP. AAP revenues of \$3.0 million increased \$0.6 million compared with the third quarter of 2012, due primarily to a 17% increase in recyclable appliances compared with the same period last year. During the third quarter of 2013, we did not recognize any carbon offset revenues. Early in the fourth quarter of 2013, we received \$0.5 million in cash related to the issuance and sale of carbon offset certificates in the California market, which will favorably impact the fourth quarter pre-tax earnings by the same amount.

Gross Profit. During the first quarter of 2013, we reclassified certain revenues, cost of revenues and sales, general and administrative expenses due to further industry analysis and conformed the 2012 presentation. The reclassification is related primarily to facilities costs and certain other costs not directly related to the production of recycled materials within the recycling segment. Our gross profit of \$9.1 million in the third quarter of 2013 increased 2.0 million, or 28% from \$7.1 million in the third quarter of 2012. Gross profit as a percentage of total revenues increased to 27% for the third quarter of 2013 compared with 25% in the third quarter of 2012. The improvement was primarily the result of four factors: (1) a reduction in the cost of recyclable appliances purchased by AAP, (2) labor efficiencies recognized by AAP, (3) the increase in appliance replacement volumes, and (4) a favorable retail sales mix. Gross profit percentage for the recycling segment improved to 28% for the third quarter of 2013 compared with 24% for the third quarter of 2012. The impact of the lower acquisition cost of recyclable appliances and processing labor per gross ton resulted in AAP's gross profit percentage improving to 27% compared with 5% in the third quarter of 2012. AAP's appliance

acquisition costs and labor costs per gross ton improved by \$54 and \$18, respectively, compared with the third quarter of 2012. Gross profit percentage for the retail segment increased to 26% for the third quarter of 2013 compared with 25% for the third quarter of 2012.

Selling, General and Administrative Expenses. Our selling, general and administrative (“SG&A”) expenses for the third quarter of 2013 decreased \$0.5 million to \$7.3 million compared with \$7.8 million for the same period of the prior year. Our SG&A expenses as a percentage of total revenues decreased to 22% in the third quarter of 2013 compared with 27% in the third quarter of 2012. Selling expenses decreased \$0.8 million to \$4.1 million or 12% of total revenues in the third quarter of 2013 compared with \$4.9 million or 17% of total revenues for the third quarter of 2012. The decrease in selling expenses was due primarily to closing the three ApplianceSmart stores mentioned previously and a \$0.3 million reduction in advertising. General and administrative expenses increased \$0.2 million to \$3.2 million for the third quarter of 2013 compared with \$3.0 million in the third quarter of the prior year. The increase was due primarily to higher corporate incentive compensation expense.

Interest expense, net: Interest expense of \$0.3 million for the third quarter of 2013 was consistent with the same period of the prior year. In connection with the third amendment to our amended Credit Agreement with PNC Bank, National Association, the interest rate on our line of credit increased by 300 basis points and increased 100 basis points on our term loan. The increase in rates was offset by a lower average outstanding balance under our line of credit. In the third quarter, we executed the fourth amendment of our credit agreement with PNC Bank, which will lower the interest rate on our line of credit by 300 basis points effective November 1, 2013. See the “Liquidity and Capital Resources” section for more detail.

Provision for Income Taxes. We recorded a provision for income taxes of \$0.2 million for the third quarter of 2013 compared with \$0.1 million for the same period of the prior year. The provision for income taxes for the third quarter of 2013 is related primarily to projected taxable income in the United States partially offset by expected benefits in Canada related to the ability to carryback 2013 losses.

Noncontrolling Interest. Noncontrolling interest represents 4301’s share of AAP’s net income or loss. Under the AAP joint venture agreement, ARCA and 4301 each have a 50% interest in AAP. AAP reported a net income of \$255,000 for the third quarter of 2013 of which \$128,000 represented the income attributable to noncontrolling interest. AAP reported a net loss of \$153,000 for the the third quarter of 2012, of which \$77,000 represented the loss attributable to noncontrolling interest.

For the Nine Months Ended September 28, 2013, and September 29, 2012

The following table sets forth the key results of operations by segment for the nine months ended September 28, 2013, and September 29, 2012 (dollars in millions):

	Nine Months Ended		
	September 28, 2013	September 29, 2012	% Change
Revenues:			
Retail	\$ 53.7	\$ 56.9	(6)%
Recycling	42.5	30.8	38 %
Total revenues	<u>\$ 96.2</u>	<u>\$ 87.7</u>	10 %
Operating income (loss):			
Retail	\$ (0.2)	\$ (1.4)	85 %
Recycling	4.2	0.6	605 %
Unallocated corporate costs	(0.6)	(0.0)	(2,795)%
Total operating income (loss)	<u>3.4</u>	<u>(0.8)</u>	507 %

Our total revenues of \$96.2 million for the nine months ended September 28, 2013, increased \$8.5 million or 10% from \$87.7 million for the nine months ended September 29, 2012. The increase in revenues was attributed to our recycling segment. Appliance replacement program revenues increased by \$13.3 million compared with the same period of the prior year, which was partially offset by a decline in recycling-only revenues of \$1.4 million and a \$3.2 million decline in ApplianceSmart revenues. Retail segment revenues accounted for 61% of total revenues in the nine months ended September 28, 2013, compared with 65% in the same period of the prior year. Recycling segment revenues and retail segment revenues each include a portion of byproduct revenues. For both the nine months ended September 28, 2013, and 2012, the recycling segment accounted for approximately

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93% of the byproduct revenues. The increase in replacement program revenues impacted the overall mix of revenues between the retail and recycling segments for the nine months ended September 28, 2013, compared with same period of the prior year. Future revenues and related earnings from appliance replacement programs, if any, are uncertain and may fluctuate significantly from year to year. Factors impacting future appliance replacement program revenues and earnings include the type and scope of energy efficiency programs approved by regulatory agencies, competitive bidding, contract changes, non-renewals and early cancellations.

Our total operating income of \$3.4 million for the nine months ended September 28, 2013, increased \$4.2 million compared with an operating loss of \$(0.8) million for the nine months ended September 29, 2012. The increase was related primarily to the increase in appliance replacement revenues, a \$1.7 million decrease in SG&A expenses and a 100-basis-point improvement in our ApplianceSmart gross margin, which includes a \$0.5 million favorable inventory reserve adjustment.

Revenues. Revenues for the nine months ended September 28, 2013, and September 29, 2012, were as follows (dollars in millions):

	Nine Months Ended		
	September 28, 2013	September 29, 2012	% Change
Retail	\$ 52.9	\$ 56.0	(6)%
Recycling	30.4	18.4	65 %
Byproduct	12.9	13.3	(2)%
	<u>\$ 96.2</u>	<u>\$ 87.7</u>	10 %

Retail Revenues. Our retail revenues of \$52.9 million for the nine months ended September 28, 2013, decreased \$3.1 million, or 6%, from \$56.0 million for the nine months ended September 29, 2012. The decrease in retail revenues was due primarily to a decline in same-store sales along with the closure of three underperforming stores that were operating for the entire nine-month in 2012. The store closures represented a \$3.4 million decline in revenues and same-store sales declined by \$1.1 million, or 2.3%. Our same-store sales includes contract sales, which increased to \$2.1 million compared to \$0.3 million in the same period of 2012. The revenue decline resulting from store closures and lower same-store sales was partially offset by \$1.4 million in revenues generated from a new store that was not operating during the same period of 2012. We are evaluating underperforming stores and stores with expiring leases that have a range of outcomes from right-sizing the showroom space to closure. We closed one underperforming store in May 2013 as a result of not renewing the lease.

Recycling Revenues. Our recycling revenues of \$30.4 million for the nine months ended September 28, 2013, increased \$12.0 million, or 65%, from \$18.4 million in the nine months ended September 29, 2012. Recycling revenues are comprised of two components: (1) appliance recycling revenues generated by collecting and recycling appliances for utilities and other sponsors of energy efficiency programs and (2) replacement program revenues generated by recycling and replacing old appliances with new energy efficient models for programs sponsored by utility companies. Appliance recycling revenues decreased 13% to \$9.2 million for the nine months ended September 28, 2013, compared with \$10.6 million in the same period of the prior year, due primarily to lower volumes and price compression within certain contracts. The number of units driving our appliance recycling revenues declined 7% and the average revenue per unit declined by \$5 compared with the same period of the prior year. Appliance replacement program revenues increased 170% to \$21.2 million in the nine months ended September 28, 2013, compared with \$7.9 million in the same period of the prior year, due primarily to higher volumes and the mix of appliance replacements. Future revenues from appliance replacement programs, if any, are uncertain and may fluctuate significantly from period to period.

Byproduct Revenues. Our byproduct revenues of \$12.9 million for the nine months ended September 28, 2013, decreased \$0.4 million, or 2%, from \$13.3 million in the same period of the prior year. The decrease in byproduct revenues was primarily the result of a decline in steel scrap prices. Byproduct revenues include all of the revenues generated by AAP. AAP revenues of \$8.3 million increased \$0.2 million compared with the same period of the prior year, due primarily to a 8% increase in volume partially offset by a decline in average steel scrap prices of 7% per gross ton compared with the same period of the prior year. During the nine months ended September 28, 2013, we did not recognize any carbon offset revenues. Early in the fourth quarter of 2013, we received \$0.5 million in cash related to the issuance and sale of carbon offset certificates in the California market, which will favorably impact the fourth quarter pre-tax earnings by the same amount. We continue to recover and store refrigerants and expect to generate carbon offset revenues in the future, although the frequency of these transactions will vary based on volume levels and market conditions.

Gross Profit. During fiscal 2013, we reclassified certain revenues, cost of revenues and sales, general and administrative expenses due to further industry analysis and conformed the 2012 presentation. The reclassification is related primarily to facilities costs and certain other costs not directly related to the production of recycled materials within the recycling segment. Our gross profit

of \$25.5 million in the nine months ended September 28, 2013, increased 2.5 million, or 11%, from \$23.0 million in the nine months ended September 29, 2012. Gross profit as a percentage of total revenues increased to 26.5% for the nine months ended September 28, 2013, compared with 26.2% in the same period of the prior year. Gross profit percentage for the recycling segment decreased to 25.3% for the nine months ended September 28, 2013, compared with 26.4% in the same period of the prior year. The decline is attributed primarily to lower byproduct revenues, lower average recycling revenues per unit and higher costs per unit. Gross profit percentage for the retail segment increased to 27.4% for the nine months ended September 28, 2013, compared with 26.1% in the same period of the prior year. The increase for the retail segment was due primarily to a favorable retail sales mix and a \$0.5 million favorable adjustment to our inventory reserve for the nine months ended September 28, 2013.

Our gross profit as a percentage of total revenues for future periods can be affected favorably or unfavorably by numerous factors, including:

1. The mix of retail products we sell.
2. The prices at which we purchase product from the major manufacturers that supply product to us.
3. The volume of appliances we receive through our recycling contracts.
4. The volume and price of byproduct materials.
5. The volume and price of carbon offset sales created by the destruction of ozone-depleting refrigerants.

Selling, General and Administrative Expenses. Our selling, general and administrative (“SG&A”) expenses for the nine months ended September 28, 2013, decreased \$1.7 million to \$22.1 million compared with \$23.8 million for the same period of the prior year. Our SG&A expenses as a percentage of total revenues decreased to 23% in the nine months ended September 28, 2013, compared with 27% in the same period last year. Selling expenses decreased \$1.5 million to \$13.1 million or 14% of total revenues in the nine months ended September 28, 2013, compared with \$14.6 million or 17% of total revenues in the same period of the prior year. The decrease in selling expenses was due primarily to closing the three ApplianceSmart stores mentioned previously and a \$0.3 million reduction in advertising. General and administrative expenses decreased \$0.2 million to \$9.0 million for the nine months ended September 28, 2013, compared with \$9.2 million in the same period of the prior year. The decrease was due primarily to expense reductions. During the first quarter of 2013, we completed several restructuring activities, including the elimination of 19 employees. The position eliminations will generate an annualized savings of approximately \$0.8 million. The expected annualized savings will be partially offset by additional expenses related to the new position hired in July 2013 of chief operating officer and president of ARCA Recycling, Inc, along with the recognition of incentive compensation.

Interest expense, net: Interest expense for the nine months ended September 28, 2013, increased \$0.1 million compared with the same period of the prior year. The increase was the result of a higher interest rate under our line of credit, which was partially offset by a lower outstanding average balance under the line of credit. In connection with our amended Credit Agreement with PNC Bank, National Association, the interest rate on our line of credit increased by 300 basis points and 100 basis points on our term loan on March 1, 2013. The increase in rates was offset by a lower average outstanding balance under our line of credit. In the third quarter, we executed the fourth amendment to our credit agreement with PNC Bank that will lower the interest rate on our line of credit by 300 basis points effective November 1, 2013. See the “Liquidity and Capital Resources” section for more detail.

Provision for Income Taxes. We recorded a provision for income taxes of \$0.4 million for the nine months ended September 28, 2013, compared with \$0.1 million for the same period of the prior year. The provision for income taxes for the nine months ended September 28, 2013, is related primarily to projected taxable income in the United States partially offset by expected benefits in Canada related to the ability to carryback 2013 losses. We estimate that we will be able to use available net operating losses (“NOLs”) to offset taxes related to a portion of our projected full-year taxable income in the United States. Due to uncertainties regarding the realization of deferred tax assets, we are continuing to carry a full valuation allowance against the deferred tax assets we do not expect to realize.

Noncontrolling Interest. Noncontrolling interest represents 4301’s share of AAP’s net loss. Under the AAP joint venture agreement, ARCA and 4301 each have a 50% interest in AAP. AAP reported a net loss of \$62,000 for the nine months ended September 28, 2013, of which \$31,000 represented the loss attributable to noncontrolling interest. AAP reported a net income of \$4,000 for the nine months ended September 29, 2012, of which \$2,000 represented the income attributable to noncontrolling interest.

Liquidity and Capital Resources

Summary. Cash and cash equivalents as of September 28, 2013, were \$2.1 million compared with \$3.2 million as of December 29, 2012. Working capital, the excess of current assets over current liabilities, increased to \$8.9 million as of September 28, 2013, compared with \$7.6 million as of December 29, 2012. The increase was primarily the result of the net impact of a lower balance under our line of credit, lower appliance inventories and higher outstanding trade receivables.

The following table summarizes our cash flows for the nine months ended September 28, 2013, and September 29, 2012 (in millions):

	Nine Months Ended	
	September 28, 2013	September 29, 2012
Total cash and cash equivalents provided by (used in):		
Operating activities	4.2	(2.1)
Investing activities	(0.8)	(0.7)
Financing activities	(4.3)	1.1
Effect of exchange rates on cash and cash equivalents	(0.1)	0.1
Decrease in cash and cash equivalents	<u>\$ (1.0)</u>	<u>\$ (1.6)</u>

Operating Activities. Our net cash provided by operating activities was \$4.2 million for the nine months ended September 28, 2013, compared with net cash used in operating activities of \$2.1 million for the nine months ended September 29, 2012. The change in operating cash was primarily the result of generating cash by lowering our appliance inventory along with generating a net income in 2013 compared with a net loss in 2012, which was partially offset by carrying a higher level of trade receivables.

Investing Activities. Our net cash used in investing activities was \$0.8 million for the nine months ended September 28, 2013, compared with \$0.7 million for the nine months ended September 29, 2012. Net cash used in investing activities for the nine months ended September 28, 2013, was related primarily to an increase in restricted cash as a result of a reserve required by our credit card processor and the purchase of cutting knives for the URT materials recovery system in Philadelphia. The net cash used in investing activities for the nine months ended September 29, 2012, was due entirely to the purchase of property and equipment.

Financing Activities. Our net cash used in financing activities was \$4.3 million for the nine months ended September 28, 2013, compared with net cash provided by financing activities of \$1.1 million for the nine months ended September 29, 2012. Net cash used in financing activities for the nine months ended September 28, 2013, was related primarily to net payments under our line of credit and the repayment of long-term debt obligations. Net cash provided by financing activities for the nine months ended September 29, 2012, was related primarily to additional borrowings under our line of credit, which was partially offset by the repayment of long-term debt obligations.

Sources of Liquidity. Our principal sources of liquidity are cash from operations and borrowings under our revolving line of credit. Our principal liquidity requirements consist of long-term debt obligations, capital expenditures and working capital. Our total capital requirements for the next twelve months will depend upon, among other things, the number and size of ApplianceSmart stores operating during the period, the recycling volumes generated from recycling contracts during the period and our needs related to AAP. Currently, we have 18 ApplianceSmart stores and 11 recycling centers, including AAP, in operation.

We believe, based on the anticipated sales per retail store, the anticipated revenues from our recycling contracts and our anticipated gross profit, that our cash balance, anticipated funds generated from operations and our revolving line of credit will be sufficient to finance our operations, long-term debt obligations and capital expenditures through at least the next twelve months. We may need additional capital to finance our operations if our revenues are lower than anticipated, our expenses are higher than anticipated or we pursue new opportunities. Sources of additional financing, if needed in the future, may include further debt financing or the sale of equity (Common or Preferred Stock) or other financing opportunities. There can be no assurance that such additional sources of financing will be available on terms satisfactory to us or permitted by our Credit Agreement.

Outstanding Indebtedness. On January 24, 2011, we entered into a Revolving Credit, Term Loan and Security Agreement, as amended, (“Credit Agreement”) with PNC Bank, National Association (“PNC”) that provides us with a \$15.0 million revolving line of credit. The Credit Agreement has a stated maturity date of January 24, 2016, if not renewed. The Credit Agreement is collateralized by a security interest in substantially all of our assets and PNC is also secured by an inventory repurchase agreement with Whirlpool Corporation for Whirlpool purchases only. We also issued a \$750,000 letter of credit in favor of Whirlpool Corporation. The Credit Agreement requires starting with the fiscal quarter ending December 28, 2013, and continuing at the end of each quarter thereafter, that we meet a minimum fixed charge coverage ratio of 1.10 to 1.00, measured on a trailing twelve-month basis. The Credit Agreement limits investments we can purchase, the amount of other debt and leases we can incur, the amount of loans we can issue to our affiliates and the amount we can spend on fixed assets, along with prohibiting the payment of dividends. The interest rate on the revolving line of credit is PNC Base Rate plus 2.75%. If certain interest rate reduction conditions are met starting January 31, 2014, the rate will change to PNC Base Rate plus 1.75%, or 1-, 2- or 3-month PNC LIBOR Rate plus 2.75%. The PNC Base Rate shall mean, for any day, a fluctuating per annum rate of interest equal to the highest of

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(i) the interest rate per annum announced from time to time by PNC at its prime rate, (ii) the Federal Funds Open Rate plus 0.5%, and (iii) the one-month LIBOR rate plus 100 basis points (1%). As of September 28, 2013, the outstanding balance under the Credit Agreement was \$6.8 million with a weighted average interest rate of 6.00%, which included only PNC Base Rate loans. As of December 29, 2012, the outstanding balance under the Credit Agreement was \$10.6 million with a weighted average interest rate of 3.07%, which included both PNC LIBOR Rate and PNC Base Rate loans. The amount of revolving borrowings under the Credit Agreement is based on a formula using accounts receivable and inventories. We may not have access to the full \$15.0 million revolving line of credit due to the formula using accounts receivable and inventories, the amount of the letter of credit issued in favor of Whirlpool Corporation and the amount of outstanding loans between PNC and our AAP joint venture. As of September 28, 2013, and December 29, 2012, our available borrowing capacity under the Credit Agreement was \$6.8 million and \$2.5 million, respectively.

On March 14, 2013, we executed the third amendment to the Credit Agreement that extended the agreement from January 24, 2014, until January 24, 2016, waived our prior “events of default,” reset our financial covenants and increased our interest rate, among other things. The material amended terms under the Credit Agreement are as follows:

- We must meet cumulative monthly minimum EBITDA requirements set forth in the amendment through 2013. We reported EBITDA as defined by the Credit Agreement of \$2,340,000 for the nine months ended September 28, 2013, compared with the minimum covenant of negative \$990,000.
- The affiliate loan balance must be reduced by \$40,000 per month in 2013 and the affiliate loan balance will be capped at \$300,000 on January 25, 2014, and thereafter. As of September 28, 2013, our outstanding affiliate loan balance was \$549,000 compared with the covenant of the same amount.
- Starting on December 28, 2013, we must meet a minimum fixed charge coverage ratio of 1.10 to 1.00 for the nine months then ended and on a trailing twelve-month basis beginning with the period ending March 30, 2014, and each quarter thereafter.
- The interest rate spread on our Revolving Loan and Term Loan increased 100 basis points for both PNC Base Rate loans and 1-, 2- or 3-month PNC LIBOR Rate loans. We are not eligible to borrow under 1-, 2- or 3-month PNC LIBOR Rate loans until certain interest rate reduction conditions are met as set forth in the amendment, which include meeting all financial covenants during 2013. If these interest rate reduction conditions are met, we will also be able to remove the 100 basis point increase for both PNC Base Rate loans and 1-, 2- or 3-month PNC LIBOR Rate loans. The earliest the interest rate reduction conditions could be met is January 31, 2014.
- A prepayment penalty will be assessed at 3% during the first year of the third amendment to our Credit Agreement, 2% during the second year and 1% during the third year.

On September 27, 2013, we executed the fourth amendment to the Credit Agreement. The material amended terms under the Credit Agreement are as follows:

- The affiliate loan balance will be held at \$469,100 until January 24, 2014, and starting in January 2014 and each month thereafter, the affiliate loan balance must be reduced by \$14,000 per month until December 31, 2014. The affiliate loan balance will be capped at \$300,000 on December 31, 2014, and thereafter.
- We will be eligible to borrow under 1-, 2- or 3-month PNC LIBOR Rate loans on November 1, 2013 if combination of ARCA and AAP receives at least \$300,000 in cash related to selling carbon offsets. On October 9, 2013, the combination of ARCA and AAP received \$516,000 in cash related to selling carbon offsets.

On January 24, 2011, we entered into a \$2.55 million Term Loan (“Term Loan”) with PNC Bank to refinance the mortgage on our California facility. The Term Loan is payable as follows, subject to acceleration upon the occurrence of an event of default or termination of the Revolving Credit Agreement: 119 consecutive monthly principal payments of \$21,000 plus interest commencing on February 1, 2011, and continuing on the first day of each month thereafter followed by a 120th payment of all unpaid principal, interest and fees on February 1, 2021. If the Revolving Credit Agreement is not renewed, a balloon payment of \$1.28 million in principal plus interest and additional fees will be due on January 24, 2016. The Term Loan is collateralized with our California facility located in Compton, California. The interest rate is PNC Base Rate plus 3.25%. If certain interest rate reduction conditions are met starting January 31, 2014, the rate will change to PNC Base Rate plus 2.25%, or 1-, 2- or 3-month PNC LIBOR Rate plus 3.25%. As of September 28, 2013, and December 29, 2012, the interest rate was 6.50% and 5.50%, respectively.

On March 10, 2011, ARCA Advanced Processing, LLC entered into three separate commercial term loans (“AAP Term Loans”) with Susquehanna Bank, pursuant to the guidelines of the U.S. Small Business Administration 7(a) Loan Program. The total

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amount of the AAP Term Loans is \$4.75 million, split into three separate loans for \$2.1 million, \$1.4 million and \$1.25 million. The AAP Term Loans mature in ten years and bear an interest rate of Prime plus 2.75%. As of September 28, 2013, and December 29, 2012, the interest rate was 6.00%. Borrowings under the AAP Term Loans are secured by substantially all of the assets of AAP along with liens on the business assets and certain personal assets of the owners of 4301 Operations, LLC. We are a guarantor of the AAP Term Loans along with 4301 Operations, LLC and its owners.

The following table summarizes our borrowings as of September 28, 2013, and December 29, 2012 (in millions):

	September 28, 2013	December 29, 2012
Line of credit	\$ 6.8	\$ 10.6
PNC Bank Term Loan	1.8	2.0
Susquehanna Bank Term Loans ⁽¹⁾	3.9	4.2
Other financing obligations and loans ⁽¹⁾	1.0	0.9
Capital leases and other financing obligations	0.2	0.2
	13.7	17.9
Less: current portion of debt	8.0	11.5
	\$ 5.7	\$ 6.4

⁽¹⁾ Represents notes from consolidating AAP.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk and Impact of Inflation

Interest Rate Risk. We do not believe there is any significant risk related to interest rate fluctuations on our long-term fixed-rate debt. There is interest rate risk on the line of credit, PNC Term Loan and Susquehanna Bank Term Loans, since our interest rate floats. The outstanding balance on our floating rate loans as of September 28, 2013, was approximately \$12.5 million. Based on average floating rate borrowings of \$14.7 million, a hypothetical 100 basis point change in the applicable interest rate would have caused our interest expense to change for the three and nine months ended September 28, 2013, by approximately \$37,000 and \$109,000, respectively.

Foreign Currency Exchange Rate Risk. We currently generate revenues in Canada. The reporting currency for our consolidated financial statements is U.S. dollars. It is not possible to determine the exact impact of foreign currency exchange rate changes; however, the effect on reported revenue and net earnings can be estimated. We estimate that the U.S. dollar against the Canadian dollar had an immaterial impact on the revenues and net income for the three and nine months ended September 28, 2013. We do not currently hedge foreign currency fluctuations and do not intend to do so for the foreseeable future.

We do not hold any derivative financial instruments nor do we hold any securities for trading or speculative purposes.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer), to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act), at September 28, 2013. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, at September 28, 2013, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

During the third quarter of fiscal 2013, there was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

PART II. Other Information

Item 1. Legal Proceedings

In December 2012, we ceased operations at our Conyers, Georgia, facility and abandoned the leased property. We believe the landlord has relet the property to a new tenant. Nonetheless, the landlord has made a claim of approximately \$500,000 against us based upon lease termination negotiations that had been progressing between the parties but ended. The landlord has filed a claim for breach of settlement in the Superior Court of Fulton County, Georgia. We are confident that we will successfully defend the claim made by the landlord as a result of the likely reletting of the property to a new tenant and we believe the possibility of a material loss is remote.

In February 2012, various individuals commenced a class action lawsuit against Whirlpool Corporation (“Whirlpool”) and various distributors of Whirlpool products, including Sears, The Home Depot, Lowe’s and us, alleging certain appliances sold by Whirlpool through its distribution chain, which includes us, were improperly designated with the ENERGY STAR® qualification rating established by the U.S. Department of Energy and the Environmental Protection Agency. The claims against us include breach of warranty claims, as well as various state consumer protection claims. The amount of the claim is, as yet, undetermined. Whirlpool has offered to fully indemnify and defend its distributors in this lawsuit, including us, and has engaged defense counsel to defend itself and the distributors. We are monitoring Whirlpool’s defense of the claims and believe the possibility of a material loss is remote.

In 2007, we entered into an agreement with AMTIM Capital, Inc. (“AMTIM”) to act as our representative to market our recycling services in Canada under an arrangement that pays AMTIM for revenues generated by recycling services in Canada as set forth in the agreement between the parties. A dispute has arisen between AMTIM and us with respect to the calculation of amounts due to AMTIM pursuant to the agreement. AMTIM claims a discrepancy in the calculation of fees due to AMTIM by us of more than \$600,000 as of mid-2010. We commenced an action in the U.S. District Court for a determination of the parties’ rights under the agreement. AMTIM started its own action in Ontario, Canada, against us for amounts it claims are due pursuant to the agreement. We moved the Canadian court for a stay of that action pending the U.S. action. AMTIM requested the U.S. District Court to stay the U.S. action pending resolution of the Canadian court action. AMTIM’s motion was denied by the U.S. District Court and as a result we obtained a default judgment against AMTIM approving the manner in which we have historically calculated fees due to AMTIM. Shortly thereafter, the Canadian court dismissed our motion to stay the Canadian action. We thereafter sought dismissal of the Canadian action for lack of jurisdiction of the Canadian courts. That motion was denied by the Canadian court. We appealed that denial and the Canadian appellate court upheld the denial indicating that the Company’s position may support a dismissal ruling on other grounds. We moved for dismissal on such other grounds and the Canadian lower court denied that motion. The Company has, similarly, appealed that decision to the Canadian appellate court. No decision has yet been rendered. Although the outcome is uncertain, we believe the possibility of a material loss is remote.

We are party from time to time to other ordinary course disputes that we do not believe to be material.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Number	Description
10.1‡	Amendment No. 3, dated July 1, 2013, to Appliance Sales and Recycling Agreement dated October 21, 2009, between General Electric Company and the Company.
10.2+	Employment agreement dated July 22, 2013, between Mark Eisenschenk and the Company.
10.3+	Amendment No. 4, dated September 27, 2013, to Revolving Credit, Term Loan and Security Agreement dated January 24, 2011, between PNC Bank, National Association and the Company.
31.1+	Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2+	Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1†	Certification by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2†	Certification by Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101**	The following materials from our Quarterly Report on Form 10-Q for the three- and nine-month periods ended September 28, 2013, formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Comprehensive Income (Loss), (iii) the Consolidated Statements of Cash Flows, (iv) the Notes to Consolidated Financial Statements, and (v) document and entity information.

+ Filed herewith.

† Furnished herewith.

‡ Filed herewith confidential treatment has been requested and portions of the exhibit have been omitted.

** Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be “filed” for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.

SIGNATURES

Pursuant to the requirements of Section 13 or Section 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on our behalf by the undersigned, thereunto duly authorized.

Dated: November 7, 2013

Appliance Recycling Centers of America, Inc.
(Registrant)

By: /s/ Edward R. Cameron

Edward R. Cameron
President and Chief Executive Officer

By: /s/ Jeffrey A. Cammerrer

Jeffrey A. Cammerrer
Chief Financial Officer

CERTAIN CONFIDENTIAL INFORMATION CONTAINED IN THIS DOCUMENT MARKED BY ASTERISKS [*], HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO RULE 24B-2 OF THE SECURITIES EXCHANGE ACT OF 1934 AS AMENDED

THIRD ADDENDUM TO AGREEMENT

WHEREAS, APPLIANCE RECYCLING CENTERS OF AMERICA (“ARCA”) and GENERAL ELECTRIC COMPANY, acting through its GE Consumer & Industrial business component entered into an Appliances Sales and Recycling Agreement dated October 21, 2009 (“Agreement”);

WHEREAS, ARCA and GE entered into an Addendum to Amend the Agreement on March 9, 2010 and July 8, 2010;

WHEREAS, GE has reorganized its business components such that GE Appliances (formerly one of the businesses comprising GE Consumer & Industrial) is now the relevant business component for purposes of the Agreement;

WHEREAS, ARCA and GE desire to further amend the Agreement as provided herein;

NOW, THEREFORE, effective as of July 1, 2013 (“Execution Date”), ARCA and GE agree to amend the Agreement as set out below.

1. GE and ARCA agree to modify Section 2.1(f) such that ARCA’s payment to GE for the purchase of Recyclable Appliances and Other Recyclable Items shall be made monthly on the basis of ARCA’s fiscal calendar (which shall be provided by ARCA to GE), with full payment for each ARCA fiscal month being received by GE via electronic funds transfer by the eighth (8th) Friday following the expiration of each such month, with GE receiving a report in the form of Schedule 2.1 (f) at least fourteen (14) days after the expiration of each such month. Such report shall be subject to audit by GE in accordance with Article 4.
2. The applicable percentage (%) of the Weekly AMM Price in Section 2.1 (e) shall be deleted in its entirety (including the deletion of Schedule 2.1(e)) and replaced with the following:

[*] signifies that confidential information has been omitted and filed separately with the Securities and Exchange Commission.

*The applicable percentage (%) of the Weekly AMM Price shall be determined as follows:

- [*]
- [*]

3. Section 5.2 (p) shall be deleted in its entirety and replaced with the following:

it will provide to GE every thirty (30) days (with the first report dated August 15, 2013) a report, in agreed upon form, with details on (1) the market value of carbon allowances (ex...auction prices and futures) and offsets, (2) RPC collections of CFC and non-CFC refrigerants and foam blowing agents, (3) all outbound RPC shipments including those for transfer, sale and relative to destruction through incineration, conversion, or disassociation of such refrigerants and foam blowing agents, (4) verification status, and (5) sales transactions. Reporting shall apply to all activities that have not yet been transacted for net cash value. Parties will evaluate the report every 180 days to determine whether additional information should be included.

For all contracted RPC transactions for refrigerants and foam blowing agents after 12/31/13, ARCA and GE will at GE's option, in good faith, negotiate an amendment to this Agreement under which ARCA would share with GE the cash received, obtained by destruction of the refrigerants or foam blowing agents, from contracted RPCs. If other financial incentives are offered in the future, including but not limited to, the disposal of refrigerants or foam blowing agents, including without limitation, a "bounty," ARCA will provide details to GE, and both parties will at GE's option negotiate an amendment to this Agreement to provide GE with a share of any such financial incentive.

4. Section 1.2(b) shall be deleted in its entirety and replaced with the following:

- Should GE desire to work with ARCA, another person, or entity for a RPC or appliance recycling service in a local (within U.S. state lines) or regional (across two or more U.S. state lines) market area ("recycling location"), whether or not such recycling location is planned to include the URT System or similar system for the collection of refrigerator and freezer foam insulation and blowing agent, GE shall be free to explore, negotiate, establish and/or enter into an agreement with any party for a recycling location.

[*] signifies that confidential information has been omitted and filed separately with the Securities and Exchange Commission.

5. The Bill of Lading form referred to in the Second Addendum is updated and attached hereto and incorporated into the Agreement as Schedule 2.1(b).
6. The Detailed Payment Report example in the Second Addendum shall be deleted in its entirety and replaced with the attached Schedule 2.1 (f)- Detailed Product Payment Report (example) which shall be incorporated into the Agreement.
7. Schedule 1.1(B) shall be amended to include SDS Locations as well as Other Distribution locations as agreed upon by the parties and may be altered via email confirmations between parties.
8. Section 11.2 Notices will be updated for GE and ARCA contacts as follows.

[*] is replaced with:

[*]
General Counsel – Home & Business Solutions
Appliance Park, Bldg. 2 Room 226
Louisville, KY 40225
Fax: [*]
Email: [*]

[*] update:

GM, Appliance Distribution Services
Appliance Park, Bldg. 6 Room 227
Louisville, KY 40225
Fax: [*]
Email: [*]

[*] is replaced with:

[*]
Email: [*]

9. The definition for Recyclable Appliances shall be deleted in its entirety and replaced with the following:
 - “is used interchangeably to refer to used and/or damaged recyclable Appliances of GE and non-GE brands, either resulting from GE’s distribution, home delivery, referral under Article 3 herein or otherwise;

[*] signifies that confidential information has been omitted and filed separately with the Securities and Exchange Commission.

and also includes any other recyclable appliances, appliance parts, or recyclable items GE requests be recycled.”

10. This Addendum, along with the Agreement, constitute the entire and only agreement between the parties regarding the subject matter thereof, and merge all prior and collateral representations concerning such subject matter. To the extent of any conflict between the terms of this Addendum and the Agreement, the terms of this Addendum shall control.

APPLIANCE RECYCLING CENTERS GENERAL ELECTRIC COMPANY
OF AMERICA GE Appliances

By: [*] By: [*]

Title: President and CEO Title: General Manager

Date: 8/19/13 Date: 08/14/13

[*] signifies that confidential information has been omitted and filed separately with the Securities and Exchange Commission.

Schedule 1.1(b)

[*]

[*] signifies that confidential information has been omitted and filed separately with the Securities and Exchange Commission.

Schedule 2.1(b) example

Ship Date: 06/15/2013

RECYCLE BILL OF LADING

Ship From Address: 11DH SPIRIT DELIVERY AND DIST S10 STATION AVE CALL B4 DEL 215-638-2001 BENSALEM, PA 19020	MS Number: 10RC009022 Total Qty: 111 SCAC: FJSC - JS FESMIRE HAULING (ARCA LANE)
Ship To Address: 10RC ARCA ADVANCED PROCESSING 4301 N DELAWARE AVENUE-BLDG A CALL B4 DEL 215-268-7500 PHILADELPHIA, PA 19137	Submit freight bills per agreement
Special Instructions: Trailer: 530094 LANE ID: 11DH - 10RC LANE NAME: BENSALEM Accts Payable LaneID:	

PRODUCT TYPE	QTY	EST TOTAL WEIGHT	NOTES
REFRIGERATOR	17	3740	
RANGE	4	520	
LAUNDRY	47	6486	
DISHWASHER	22	1958	
WATER SYSTEM	2	230	
COOKTOP	6	300	
MICROWAVE	11	605	
ACCESSORY	2	40	
TOTAL :	111	13879	

Shipper Sign _____ Print Name _____ Date _____	Recipient Sign _____ Print Name _____ Date _____
Carrier Sign _____ Print Name _____ Date _____	Seal Number Verified? YES/NO Seal No#: 3711175



10RC009022

Schedule 2.1(f) DPR example

[*]

[*] signifies that confidential information has been omitted and filed separately with the Securities and Exchange Commission.

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (this "Agreement") between Appliance Recycling Centers of America, Inc. (ARCA), along with its successors and/or assigns, (the "Company") and Mark Eisenschenk (the "Employee") is entered into and dated as of July 22, 2013 (the "Effective Date").

WHEREAS, the Company desires to employ Employee as the Company's Chief Operating Officer and the Employee desires to accept such employment;

NOW, THEREFORE, in consideration of the foregoing and the mutual promises and covenants contained herein, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. Employment. During the term of this Agreement, the Company shall employ Employee as Chief Operating Officer (COO). Employee shall have such authority, responsibilities and duties as may from time to time be assigned by the Board of Directors and/or Chief Executive Officer (CEO) of the Company. Employee agrees to serve the Company faithfully and to the best of Employee's ability, and to devote Employee's full business time, attention and efforts to the business and affairs of the Company. Employee will perform all of his responsibilities in compliance with all applicable laws and regulations, and he will ensure that all Company operations comply with all applicable laws and regulations. Further, Employee will comply with all rules, policies and procedures of the Company as modified from time to time.

2.Compensation.

(A) Base Salary. During the term of this Agreement, the Company shall pay Employee an annual base salary of \$185,000. The Company shall pay the annual base salary in equal pro rata installments on the Company's regular payroll dates. The Company shall also withhold and deduct from such installment payments such amounts as are required under federal, state and local law to be withheld for income tax or Social Security withholding purposes.

(B) Benefits. Employee may participate in all benefit plans, retirement plans and fringe benefits which may be available from time to time to employees of Employee's level of employment in accordance with the Company's policies. Employee shall be entitled to up to four weeks of non-accountable vacation per year. Non-accountable means no amounts shall be accrued, no amounts shall be carried over and no amounts shall be due Employee upon termination of employment. Employee's participation in such benefits shall be subject to the terms of the applicable plans, as the same may be amended from time to time. The Company does not guarantee the adoption or continuance of any particular

employee benefit during Employee's employment, and nothing in this Agreement is intended to, or shall in any way restrict the right of the Company, to amend, modify or terminate any of its benefits during the term of this Agreement or Employee's employment with the Company.

(C) Incentive Compensation. Based on the Company's successful financial performance and/or other applicable criteria, Employee shall be eligible to be paid an annual bonus as determined by the Board of Directors in its sole discretion.

(D) Stock Options. Subject to the terms and conditions set forth herein and in the Company's Stock Option Plan, the Company will grant to Employee options to purchase up to 100,000 shares of the Company's common stock. The options shall vest as follows: (1) 16,667 options shall vest on each of the first and second anniversary dates of this Agreement, and 16,666 options shall vest on the third anniversary date of this Agreement, provided that Employee remains employed with the Company under this Agreement on the foregoing anniversary dates; and (2) the remaining 50,000 options (the "Performance Incentive Options") shall vest in equal, proportionate amounts over the term of this Agreement provided that calendar-year performance objectives established by the Board of Directors are met by Employee, as determined in the sole discretion of the Board of Directors, and Employee remains employed with the Company under this Agreement through the end of the subject calendar year. The vesting of any Performance Incentive Options shall be determined within sixty (60) days of the end of each calendar year. Performance Incentive Options that accrue during a calendar year, but do not vest upon the conclusion of such calendar year because performance objectives were not achieved, shall be deemed forfeited.

(E) Other. Employee shall be paid a \$600 monthly car allowance. In addition, the Company shall reimburse Employee's reasonable monthly cell phone charges.

3 . Term. The term of this Agreement shall begin on the Effective Date and end on July 31, 2016, unless earlier terminated pursuant to Section 4.

4. Termination.

(A) Termination by the Company for Cause. The Company may terminate this Agreement for Cause effective immediately upon notice to Employee of such termination. "Cause" means (i) material willful failure by Employee to meet objectives set by the Board of Directors and/or the CEO of the Company, (ii) material willful failure by Employee to perform Employee's duties under this Agreement or comply with the directions of the Board of Directors or the CEO of the Company, (iii) malfeasance or gross negligence in the performance of Employee's duties under this Agreement, (iv) Employee's commission of (a) a felony, (b) material unethical business practice on the part of Employee

in connection with the affairs of the Company or (c) a material breach of any of the provisions of this Agreement. Upon termination of this Agreement for Cause pursuant to this Section 4(A), the Company's obligation to pay any amount to Employee, including but not limited to any base salary, incentive compensation, or any amount payable under any benefit plan or otherwise, shall immediately cease and the Company shall have no further obligation to Employee.

(B) Termination by the Company without Cause. The Company may terminate this Agreement without Cause, effective immediately upon notice to Employee. In the event of termination of this Agreement by the Company without Cause, and provided that Employee executes a general release of all claims in a form acceptable to the Company, the Company shall pay employee severance compensation in the form of continuing payment of Employee's base salary for a period of twelve (12) months following the date of termination or until Employee enters into an employment, consulting, or other business arrangement or relationship with another person/entity, whichever date is earlier. Employee understands and agrees that his receipt of severance compensation pursuant to this paragraph is expressly conditioned on his execution of a full and complete general release of claims in a form acceptable to Company. If Employee does not sign such a general release of claims, Employee shall not be entitled to receive any further compensation under the provisions of this Agreement after the date of termination. Any severance payment made under this Agreement will be paid according to Company's normal payroll schedule and policies.

(C) Termination upon Death or Disability. This Agreement shall terminate immediately upon Employee's death or disability. For purposes of this Agreement, "Disability" means Employee's inability to perform the essential functions, duties and responsibilities contemplated under this Agreement, with or without reasonable accommodation, for a period of more than ninety (90) consecutive days due to any physical or mental incapacity or impairment,

(D) Termination by Employee. Employee may terminate this Agreement by providing the Company with ninety (90) days advance written notice of his intention to terminate the Agreement and his employment with the Company.

(E) Termination by Mutual Agreement. The Company and Employee may terminate this Agreement at any time by mutual, written consent.

Upon termination of Employee's employment with the Company for any reason, Employee shall deliver promptly to the Company all property of the Company in Employee's possession, custody or control including, without limitation: keys and/or access cards; clothing; computer or system passwords; vehicles; computers and other electronic devices, including cellular telephones; and the originals or any copies of files, records and/or documents concerning or relating to the Company, whether maintained in hard copy or electronic form, and whether maintained in their original state, in abstract or summary form, including any such materials or data addressing, identifying or reflecting the Company's

business plans or strategies, marketing plans or strategies, customers, financial condition and/or performance, sales strategies or techniques, or other confidential, proprietary and/or trade secret information of the Company. Employee agrees that he will not retain, use or provide to others a copy of any Company Confidential Information or other property in any form, including electronic, abstract, or summary form, at any time following the termination of Employee's employment with the Company.

Except in the case of possible severance compensation upon termination by the Company without Cause (as set forth in Paragraph 4(B)), in the event that Employee's employment with the Company is terminated, Employee shall be entitled only to such compensation, expense reimbursement, allowance or other remuneration as is due and owing to Employee as of the date of termination. Without limiting the foregoing, Employee shall not be entitled to any compensation for accrued but unused vacation or other paid time off upon the termination of employment with the Company.

5. Confidential Information. Employee understands and agrees that as an employee of the Company, Employee will receive, have access to, or contribute various proprietary, confidential, and/or trade secret information concerning the Company, its business operations, affairs, strategies, and clients, including, without limitation: trade secrets; customer lists, records and other information regarding customers (whether or not evidenced in writing); information regarding actual or prospective customer needs or preferences; price lists and pricing policies, financial plans, projections, records, ledgers and information; vendor profiles; purchase orders, agreements and related data; business development plans; sales, marketing and/or advertising plans or strategies; merchandising plans and strategies; research and development plans; employment records, data and policies, including information regarding the skills and abilities of Company personnel; tax or financial information; business and sales methods and operations; billing practices; business correspondence, memoranda and other records; inventions, improvements and discoveries; processes and methods; and business operations and related data formulae; computer records and related data; software code, know-how, research and development; trademark, technology, technical information, and copyrighted material; plans, designs, and related know-how; and any other confidential or proprietary data and information which Employee encounters during employment with the Company, whether in written, electronic or other form (collectively referred to hereafter as "Confidential Information").

Employee agrees that at all times during the period of Employee's employment and after the termination thereof for any reason whatsoever, Employee will hold in the strictest confidence, will keep secret, and will not disclose, use, or publish any of the Company's Confidential Information, except as such disclosure, use or publication may be required in connection with Employee's work for the Company. Employee hereby assigns to the Company any rights Employee may have or acquire in the Confidential Information and agrees that all of the Confidential Information is and shall be the sole property of the Company and its successors and assigns. Employee acknowledges and agrees that the Company's Confidential Information constitutes a unique and valuable asset of the Company and represents a substantial investment of time and expense by the Company,

and that any disclosure or other use of such knowledge or information other than for the sole benefit of the Company would be wrongful and would cause irreparable harm to the Company. Employee further understands and agrees that the confidentiality obligations set forth in this Article are continuing in nature, survive the termination of this Agreement or Employee's employment, and restrict Employee's activities following the termination of this Agreement or Employee's employment.

When Employee's employment with the Company comes to an end for any reason, or at any other time the Company so requests, Employee will give or return to the Company all records and any compositions, articles, devices, equipment, software, programs, and other items that disclose or contain Confidential Information or any summary, abstract or derivation thereof. This includes all copies or specimens in Employee's possession, whether prepared or made by others or Employee. Employee shall acknowledge in writing the return of all such materials, when requested to do so by the Company. Employee shall also refrain from accessing Company's files via computer or modem when so requested by the Company.

6 . Employee Non-Solicitation Agreement. Employee understands and agrees that the Company's workforce constitutes an important and vital aspect of its business. Employee agrees that during the term of his employment by the Company, and for a period twenty-four (24) consecutive months from the date of termination of such employment for whatever reason (whether occasioned by Employee or Company), Employee shall not, directly or indirectly, on behalf of himself or any person, firm, corporation, association or other entity, (a) solicit, or assist anyone else in the solicitation of, any of the Company's then-current employees to terminate their employment with the Company; (b) hire or engage any of the Company's then-current employees; or (c) otherwise encourage or induce any of the Company's then-current employees to terminate their employment with the Company.

7. Obligations to Third Parties. Employee hereby confirms, represents and warrants that Employee is under no contractual or other legal commitments to any other person or entity that would restrict or prevent Employee's performance of duties for the Company. Employee shall provide the Company with copies of any previous employment agreements or contracts with any of Employee's prior employers, or confirm that he is not subject to any agreements with any other employers. If Employee possesses any proprietary information of another person or entity as a result of prior employment or relationship, Employee shall honor any legal obligation that Employee has with that person or entity with respect to such proprietary information and Employee shall not use or disseminate any such proprietary information at any time during his employment with the Company.

8 . Assignment. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns, except that neither this Agreement nor any of the rights, interests or obligations hereunder may be assigned by Employee without the prior written consent of the Company.

9. Severability. If any provision of this Agreement is determined to be prohibited by or unenforceable or invalid under applicable law, such provision will be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement.

10. Entire Agreement. This Agreement contains the entire agreement between the parties with respect to the subject matter hereof and supersedes any prior understandings, agreements or representations by or between the parties.

11. No Waiver. No term or condition of this Agreement shall be deemed to have been waived except by a statement in writing signed by the party against whom enforcement of the waiver or estoppel is sought.

12. Governing Law. The validity, interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of Minnesota, without regard to conflicts of laws principles thereof.

13. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which shall be deemed one agreement.

14. Knowing, Voluntary Agreement. Employee hereby acknowledges and states that he has read this Agreement fully and carefully; that the Agreement is written in language that is understandable to him, and that he fully appreciates the meaning of its terms; and that he enters into this Agreement freely and voluntarily. Employee has sought, or has had the opportunity to seek, independent legal counsel of Employee's choice to the extent Employee deemed such advice necessary in connection with the review and execution of this Agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first above written.

APPLIANCE RECYCLING CENTERS
OF AMERICA, INC.

By: /s/Edward R. Cameron
Name: Edward R. Cameron
Title: President and CEO

/s/Mark Eisenschenk
MARK EISENSCHENK

FOURTH AMENDMENT TO REVOLVING CREDIT, TERM LOAN AND SECURITY AGREEMENT

This Fourth Amendment to Revolving Credit, Term Loan and Security Agreement (this "Amendment") is made as of this 27th day of September, 2013 among **APPLIANCE RECYCLING CENTERS OF AMERICA, INC.**, a Minnesota corporation ("ARCA"), **ARCA RECYCLING, INC.**, a California corporation ("ARCA Recycling"), **ARCA CANADA INC.**, an Ontario, Canada, corporation ("ARCA Canada"), **APPLIANCE SMART, INC.**, a Minnesota corporation ("ApplianceSmart," together with ARCA, ARCA Recycling and ARCA Canada, collectively, the "Borrowers" and each individually, a "Borrower"), certain financial institutions party to the Credit Agreement from time to time as lenders (collectively, the "Lenders"), and **PNC BANK, NATIONAL ASSOCIATION**, as agent and lender ("PNC," in such capacity, "Agent").

RECITALS

A. The Borrowers, Lenders and PNC are parties to that certain Revolving Credit, Term Loan and Security Agreement dated as of January 24, 2011 (as the same may have been amended, supplemented or otherwise modified from time to time prior to the date hereof, the "Credit Agreement"), pursuant to which PNC has made certain loans to, and extensions of credit for the account of, the Borrowers. The Credit Agreement and all other documents executed in connection therewith to the date hereof are collectively referred to as the "Existing Financing Agreements." All capitalized terms used not otherwise defined herein shall have the meaning ascribed thereto in the Credit Agreement, as amended hereby.

B. The Borrowers have requested, and PNC has agreed, to amend certain provisions of the Credit Agreement subject to the terms and conditions of this Amendment.

NOW THEREFORE, with the foregoing background hereinafter deemed incorporated by reference herein and made part hereof, the parties hereto, intending to be legally bound, promise and agree as follows:

1. Amendments to Credit Agreement.

(a) **Interest Rates.** Notwithstanding anything to the contrary contained in that certain Third Amendment to Revolving Credit, Term Loan and Security Agreement dated as of March 14, 2013 (the "Third Amendment") among Borrowers, Agent and Lenders, commencing upon satisfaction of the LIBOR Reinstatement Conditions (as defined below), but not prior to November 1, 2013: (i) Borrowing Agent may request that Advances be made as, or converted to, Eurodollar Rate Loans as set forth in Sections 2.2 and 2.4 of the Credit Agreement, and (ii) Section 1(d) of the Third Amendment shall be of no force or effect. For purposes of this Amendment, the "LIBOR Reinstatement Conditions" shall mean (x) combination of the Borrowers and the AAP Joint Venture shall have received at least \$300,000 of carbon offset cash proceeds from the applicable Governmental Body, and (y) no Default or Event of Default shall have occurred from the date of this Amendment.

(b) **Loans.** As of the Effective Date, Section 7.5 of the Credit Agreement is amended and restated as follows:

7.5 **Loans.** Make advances, loans or extensions of credit to any Person, including any Parent, Subsidiary or Affiliate except (i) with respect to the extension of commercial trade credit in connection with the sale of Inventory in the Ordinary Course of Business, and (ii) Borrowers may make loans to the AAP Joint Venture; provided, that, for each applicable time period set forth below, the aggregate amount of such loans shall not exceed the amount set forth below opposite such time period:

Time Period	Maximum amount of loans to AAP Joint Venture
From September 19, 2013, through and including December 31, 2013	\$469,100
As of January 25, 2014	\$455,000
As of February 22, 2014	\$440,900
As of March 29, 2014	\$426,800
As of April 26, 2014	\$412,700
As of May 24, 2014	\$398,600
As of June 28, 2014	\$384,500
As of July 26, 2014	\$370,400
As of August 23, 2014	\$356,300
As of September 27, 2014	\$342,200
As of October 25, 2014	\$328,100
As of November 22, 2014	\$314,000
As of December 31, 2014 and at all times thereafter	\$300,000

2. **Representations, Warranties, Covenants.** Each Borrower hereby:

(a) represents and warrants to the Agent and the Lenders that all representations and warranties set forth in the Credit Agreement and all of the other Existing Financing Agreements are true and correct in all material respects as of the date hereof (except to the extent any such representations and warranties specifically relate to a specific date, in which case such representations and warranties were true and correct in all material respects on and as of such other specific date);

(b) reaffirms all of the covenants contained in the Credit Agreement as amended hereby and covenants to abide thereby until the satisfaction in full of the Obligations and the termination of the commitments of the Lenders under the Credit Agreement;

(c) represents and warrants to the Agent and the Lenders that no Default or Event of Default has occurred and is continuing under any of the Existing Financing Agreements;

(d) represents and warrants to the Agent and the Lenders that it has the authority and legal right to execute, deliver and carry out the terms of this Amendment, that such actions were duly authorized by all necessary corporate or company action, as applicable, and that the officers executing this Amendment on its behalf were similarly authorized and empowered, and that this Amendment does not contravene any provisions of its organizational documents or of any contract or agreement to which it is a party or by which any of its properties are bound; and

(e) represents and warrants to the Agent and the Lenders that this Amendment is valid, binding and enforceable against the Borrowers in accordance with its terms except as such enforceability may be limited by any applicable bankruptcy, insolvency, moratorium or similar laws affecting creditors' rights generally and by general principles of equity (whether enforcement is sought in equity or at law).

3. **Amendment Fee.** A fee of \$10,000 (the "Fourth Amendment Fee") shall be fully earned by the Agent and the Lenders as of the Effective Date.

4. **Conditions Precedent/Effectiveness Conditions.** This Amendment shall be effective upon the date (the "Effective Date") when all of the following conditions precedent have been satisfied:

(a) Agent shall have received this Amendment fully executed by Borrowers and the Lenders;

(b) Agent shall have received the Fourth Amendment Fee in immediately available funds;

(c) No Default or Event of Default shall have occurred and be continuing;

(d) Agent shall have received an original executed signature page from Borrowers for the Third Amendment; and

(e) Agent shall have received a Stock Power for 10,000 shares of ApplianceSmart, Inc., a Minnesota corporation, evidenced by Certificate No. 1 of such company.

5. **Further Assurances.** Each Borrower hereby agrees to take all such actions and to execute and/or deliver to Agent and Lenders all such documents, assignments, financing statements and other documents, as Agent and Lenders may reasonably require from time to time, to effectuate and implement the purposes of this Amendment.

6. **Payment of Expenses.** Borrowers shall pay or reimburse Agent for its reasonable attorneys' fees and expenses in connection with the preparation, negotiation and execution of this Amendment and the documents provided for herein or related hereto.

7. **Reaffirmation of Credit Agreement.** Except as modified by the terms hereof, all of the terms and conditions of the Credit Agreement, as amended by this Amendment, and all other of the Other Documents are hereby reaffirmed and shall continue in full force and effect as therein written.

8. **Miscellaneous.**

(a) **Third Party Rights.** No rights are intended to be created hereunder for the benefit of any third party donee, creditor, or incidental beneficiary.

(b) **Loan Document.** This Amendment is an “Other Document” as defined and described in the Credit Agreement and all of the terms and provisions of the Credit Agreement relating to Other Documents shall apply hereto.

(c) **Headings.** The headings of any paragraph of this Amendment are for convenience only and shall not be used to interpret any provision hereof.

(d) **Governing Law.** This Amendment shall be governed by and construed in accordance with the laws of the State of Illinois.

(e) **Severability.** Any provision of this Amendment which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction

(f) **Counterparts.** This Amendment may be executed in any number of counterparts and by facsimile, PDF or other electronic transmissions, each of which when so executed shall be deemed to be an original and all of which taken together shall constitute one and the same agreement.

(g) **Successors and Assigns.** This Amendment shall be binding upon and inure to the benefit of the parties hereto and its respective successors and assigns.

[SIGNATURES TO APPEAR ON FOLLOWING PAGES]

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed as of the date first written above.

BORROWERS: APPLIANCE RECYCLING CENTERS OF AMERICA, INC.

By: /s/Edward R. Cameron
Name: Edward R. Cameron
Title: President and CEO

ARCA RECYCLING, INC.

By: /s/Edward R. Cameron
Name: Edward R. Cameron
Title: CEO

ARCA CANADA INC.

By: /s/Edward R. Cameron
Name: Edward R. Cameron
Title: President and CEO

APPLIANCESMART, INC.

By: /s/Edward R. Cameron
Name: Edward R. Cameron
Title: CEO

[SIGNATURE PAGE TO FOURTH AMENDMENT]

AGENT AND LENDER: PNC BANK, NATIONAL ASSOCIATION,
as Lender and as Agent

By: /s/Timothy

Canon

Timothy Canon, Vice President

200 S. Wacker Drive, Suite 600
Chicago, IL 60606

[SIGNATURE PAGE TO FOURTH AMENDMENT]

CERTIFICATIONS:

I, Edward R. Cameron, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Appliance Recycling Centers of America, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of and for the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2013

/s/ Edward R. Cameron

Edward R. Cameron

President and Chief Executive Officer

CERTIFICATIONS:

I, Jeffrey A. Cammerrer, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Appliance Recycling Centers of America, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of and for the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2013

/s/ Jeffrey A. Cammerrer

Jeffrey A. Cammerrer
Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. §1350 (as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002), the undersigned Chief Executive Officer of Appliance Recycling Centers of America, Inc. (the “Company”) hereby certifies that the Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 28, 2013 (the “Report”) fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 7, 2013

/s/ Edward R. Cameron _____
Edward R. Cameron
President and Chief Executive
Officer

* A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. §1350 (as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002), the undersigned Chief Financial Officer of Appliance Recycling Centers of America, Inc. (the “Company”) hereby certifies that the Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 28, 2013 (the “Report”) fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 7, 2013

/s/ Jeffrey A. Cammerrer

Jeffrey A. Cammerrer

Chief Financial Officer

* A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.