

---

---

**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 October 2, 2010

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 9, 2010, there were outstanding 5,492,777 shares of the registrant's Common Stock, without par value.

---

---

**APPLIANCE RECYCLING CENTERS OF AMERICA, INC.  
INDEX TO FORM 10-Q**

	<u>Page</u>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<u>Item 1. Financial Statements</u>	2
<u>Consolidated Balance Sheets as of October 2, 2010 (unaudited) and January 2, 2010</u>	2
<u>Unaudited Consolidated Statements of Operations for the Three and Nine Months Ended October 2, 2010 and October 3, 2009</u>	3
<u>Unaudited Consolidated Statements of Cash Flows for the Nine Months Ended October 2, 2010 and October 3, 2009</u>	4
<u>Notes to Unaudited Consolidated Financial Statements</u>	5
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	23
<u>Item 4. Controls and Procedures</u>	24

**PART II. OTHER INFORMATION**

<a href="#">Item 1. Legal Proceedings</a>	25
<a href="#">Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</a>	25
<a href="#">Item 3. Defaults Upon Senior Securities</a>	25
<a href="#">Item 5. Other Information</a>	25
<a href="#">Item 6. Exhibits</a>	26
<b><a href="#">SIGNATURES</a></b>	27

[Table of Contents](#)**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

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

	October 2, 2010 (unaudited)	January 2, 2010
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,945	\$ 2,799
Accounts receivable, net of allowance of \$41 at each period	6,048	4,252
Inventories, net of reserves of \$343 and \$519, respectively	16,573	16,785
Other current assets	1,217	532
Deferred income taxes	677	677
Total current assets	28,460	25,045
Property and equipment, net	9,772	4,139
Restricted cash	701	700
Other assets	1,819	1,566
Total assets (a)	\$ 40,752	\$ 31,450
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 5,495	\$ 3,364
Checks issued in excess of cash in bank	—	410
Accrued expenses	5,908	4,401
Line of credit	12,692	12,419
Current maturities of long-term obligations	586	544
Income taxes payable	94	188
Total current liabilities	24,775	21,326
Long-term obligations, less current maturities	2,444	1,963
Deferred gain, net of current portion	1,461	1,827
Deferred income tax liabilities	691	691
Total liabilities (a)	29,371	25,807
Commitments and contingencies	—	—
Shareholders' equity:		
Common Stock, no par value; 10,000 shares authorized; issued and outstanding: 5,493 shares and 4,578 shares, respectively	19,335	17,278
Accumulated deficit	(9,561)	(11,267)
Accumulated other comprehensive loss	(330)	(368)
Total shareholders' equity	9,444	5,643
Noncontrolling interest	1,937	—
Total equity	11,381	5,643
Total liabilities and shareholders' equity	\$ 40,752	\$ 31,450

(a) Assets and liabilities of the consolidated variable interest entity were \$7,419 and \$1,850, respectively, as of October 2, 2010.

See Notes to Consolidated Financial Statements.

[Table of Contents](#)

## (In Thousands, Except Per Share Amounts)

	Three Months Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
<b>Revenues:</b>				
Retail	\$ 16,771	\$ 17,962	\$ 56,508	\$ 58,229
Recycling	6,544	7,006	17,159	16,942
Byproduct	4,023	1,037	9,148	2,384
<b>Total revenues</b>	<b>27,338</b>	<b>26,005</b>	<b>82,815</b>	<b>77,555</b>
Costs of revenues	18,477	17,512	57,250	55,148
Gross profit	8,861	8,493	25,565	22,407
Selling, general and administrative expenses	7,543	7,638	22,790	23,378
Operating income (loss)	1,318	855	2,775	(971)
<b>Other income (expense):</b>				
Interest expense, net	(245)	(325)	(742)	(900)
Other income (expense), net	15	36	5	(35)
Income (loss) before income taxes and noncontrolling interest	1,088	566	2,038	(1,906)
Provision for income taxes	166	150	395	51
Net income (loss)	922	416	1,643	(1,957)
Net (income) loss attributable to noncontrolling interest	(37)	—	63	—
<b>Net income (loss) attributable to controlling interest</b>	<b>\$ 885</b>	<b>\$ 416</b>	<b>\$ 1,706</b>	<b>\$ (1,957)</b>
<b>Income (loss) per common share:</b>				
Basic	\$ 0.16	\$ 0.09	\$ 0.33	\$ (0.43)
Diluted	\$ 0.16	\$ 0.09	\$ 0.32	\$ (0.43)
<b>Weighted average common shares outstanding:</b>				
Basic	5,493	4,578	5,191	4,578
Diluted	5,686	4,578	5,400	4,578

See Notes to Consolidated Financial Statements.

[Table of Contents](#)

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

	Nine Months Ended	
	October 2, 2010	October 3, 2009
<b>Operating activities</b>		
Net income (loss)	\$ 1,643	\$ (1,957)
Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	1,062	985
Share-based compensation	336	445
Other	7	149
Amortization of deferred gain	(366)	—
Changes in assets and liabilities:		
Accounts receivable	(1,807)	398
Inventories	223	900
Other current assets	(283)	263
Other assets	(868)	(29)
Accounts payable and accrued expenses	3,336	501
Income taxes payable	(93)	(194)
<b>Net cash flows provided by operating activities</b>	<b>3,190</b>	<b>1,461</b>
<b>Investing activities</b>		
Increase in restricted cash	(1)	(700)
Consolidation of ARCA Advanced Processing, LLC (AAP)	31	—
Proceeds from sale of property and equipment	11	4,638
Investment in DALI	—	(263)
Purchases of property and equipment	(3,022)	(421)
<b>Net cash flows provided by (used in) investing activities</b>	<b>(2,981)</b>	<b>3,254</b>
<b>Financing activities</b>		
Checks issued in excess of cash in bank	(410)	516
Net borrowings (payments) under line of credit	273	(2,988)
Payments on long-term obligations	(679)	(3,086)
Proceeds from issuance of Common Stock, net of offering costs	1,721	—
<b>Net cash flows provided by (used in) financing activities</b>	<b>905</b>	<b>(5,558)</b>
Effect of changes in exchange rate on cash and cash equivalents	32	52
Increase (decrease) in cash and cash equivalents	1,146	(791)
Cash and cash equivalents at beginning of period	2,799	3,498
<b>Cash and cash equivalents at end of period</b>	<b>\$ 3,945</b>	<b>\$ 2,707</b>

**Supplemental disclosures of cash flow information**

Cash payments for interest	\$ 732	\$ 902
Cash payments for income taxes, net	\$ 488	\$ 384
<b>Non-cash investing and financing activities</b>		
Equipment acquired under capital lease	\$ —	\$ 220
Deferred gain on sale-leaseback of building	\$ —	\$ 2,441
Loan receivable in other assets exchanged for equity in AAP	\$ 375	\$ —
Acquisition of AAP:		
Fair value of assets acquired, less cash acquired	\$ 3,927	\$ —
Assumed liabilities	\$ 1,958	\$ —

See Notes to Consolidated Financial Statements.

[Table of Contents](#)

**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 selling new major household appliances through a chain of Company-owned factory outlet stores under the name ApplianceSmart®. We also provide turnkey appliance recycling and replacement services for electric utilities and other sponsors of energy efficiency programs.

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 October 2, 2010 and October 3, 2009 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 January 2, 2010 included in the Company’s Form 10-K filed with the SEC on March 18, 2010.

*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.

ARCA Canada Inc., a Canadian corporation, is a wholly-owned subsidiary. ARCA Canada was formed in September 2006 to provide turnkey recycling services for electric utility energy efficiency programs. ARCA California, Inc., a California corporation, is a wholly-owned subsidiary. ARCA California was formed in November 1991 to provide turnkey recycling services for electric utility efficiency programs. The operating results of ARCA Canada and ARCA California are consolidated in our financial statements.

ARCA Advanced Processing, LLC (“AAP”) is a joint venture that was formed in October 2009 between ARCA and 4301 Operations, LLC (“4301”) to support ARCA’s agreement with General Electric Company acting through its GE Consumer & Industrial business (“GE”). Both ARCA and 4301 have a 50% interest in AAP. GE sells all of its recyclable appliances generated in the northeastern 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. 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.

**2. Recent Accounting Pronouncements**

*Consolidation of Variable Interest Entities*

On January 3, 2010, we adopted new accounting guidance related to consolidation of variable interest entities. The new guidance addresses the effects of eliminating the qualified special purpose entity concept and responds to concerns about the application of accounting guidance related to the consolidation of variable interest entities, including concerns over the transparency of enterprises’ involvement with variable interest entities. The new guidance is effective for fiscal years beginning after November 15, 2009. The new guidance did not impact our consolidated financial statements upon adoption on January 3, 2010. We applied the new guidance in determining whether to consolidate AAP upon the capitalization and commencement of operations on February 8, 2010.

[Table of Contents](#)

*Accounting for Transfers of Financial Assets*

On January 3, 2010, we adopted new accounting guidance related to accounting for transfers of financial assets. The new guidance eliminates the concept of a “qualified special-purpose entity,” changes the requirements for derecognizing financial assets and requires additional disclosures in order to enhance information reported to users of financial statements by providing greater transparency about transfers of financial assets, including securitization transactions, and an entity’s continuing involvement in and exposure to the risks related to transferred financial assets. The new guidance is effective for fiscal years beginning after November 15, 2009. The new guidance did not have a material impact on the preparation of our consolidated financial statements.

*Fair Value Measurement Disclosures*

In January 2010, the Financial Accounting Standards Board issued new accounting guidance which requires new disclosures for assets and liabilities measured at fair value. The requirements include expanded disclosure of valuation methodologies for fair value measurements, transfers between levels of the fair value hierarchy, and gross rather than net presentation of certain changes in Level 3 fair value measurements. The new required disclosures are effective for interim and annual periods beginning after December 15, 2009, except for requirements related to gross presentation of certain changes in Level 3 fair value measurements, which are effective for interim and annual periods beginning after December 15, 2010. We implemented the portions of the guidance required on January 3, 2010, and the implementation did not have a material impact on the preparation of our consolidated financial statements.

### 3. Significant Accounting Policies

**Cash and cash equivalents:** We consider all highly liquid investments purchased with original maturity dates of three months or less to be cash equivalents. We maintain our cash in bank deposit and money-market accounts which, at times, exceed federally insured limits. We have determined that the fair value of our money-market accounts fall within Level 1 of the fair value hierarchy. We have not experienced any losses in such accounts.

**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 \$41 to be adequate to cover any exposure to loss as of both October 2, 2010 and January 2, 2010.

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

	October 2, 2010	January 2, 2010
Finished goods	\$ 16,755	\$ 17,304
Work in process	161	—
Less provision for inventory obsolescence	(343)	(519)
	<u>\$ 16,573</u>	<u>\$ 16,785</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.

### [Table of Contents](#)

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

	October 2, 2010	January 2, 2010
Land	\$ 1,140	\$ 1,140
Buildings and improvements	3,091	2,990
Equipment (including computer software)	15,567	9,082
	19,798	13,212
Less accumulated depreciation and amortization	(10,026)	(9,073)
	<u>\$ 9,772</u>	<u>\$ 4,139</u>

**Software development costs:** We capitalize software developed for internal use and are amortizing such costs over their estimated useful lives of three to five years. Costs capitalized were \$25 and \$23 for the three months ended October 2, 2010 and October 3, 2009, respectively. Costs capitalized were \$83 and \$171 for the nine months ended October 2, 2010 and October 3, 2009, respectively.

**Impairment of long-lived assets:** We evaluate long-lived assets such as property and equipment for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. We assess impairment based on the estimated future net undiscounted cash flows expected to result from the use of the assets, including cash flows from disposition. Should the sum of the expected future net cash flows be less than the carrying value, we recognize an impairment loss at that time. We measure an impairment loss by comparing the amount by which the carrying value exceeds the fair value (estimated discounted future cash flows or appraisal of assets) of the long-lived assets. We recognized no impairment charges during the three and nine months ended October 2, 2010 and October 3, 2009.

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

**Accounting for leases:** We conduct the majority of our retail and recycling operations from leased facilities. The majority of our leases require payment of real estate taxes, insurance and common area maintenance in addition to rent. The terms of our lease agreements typically range from five to ten years. Most of the leases contain renewal and escalation clauses, and certain store leases require contingent rents based on factors such as revenue. For leases that contain predetermined fixed escalations of the minimum rent, we recognize the related rent expense on a straight-line basis from the date we take possession of the property to the end of the initial lease term. We record any difference between straight-line rent amounts and amounts payable under the leases as part of deferred rent in accrued expenses. Cash or lease incentives (tenant allowances) received upon entering into certain store leases are recognized on a straight-line basis as a reduction to rent from the date we take possession of the property through the end of the initial lease term.

**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			
	October 2, 2010		October 3, 2009		October 2, 2010		October 3, 2009	
Beginning Balance	\$	55	\$	82	\$	67	\$	91
Standard accrual based on units sold		10		19		41		60
Actual costs incurred		(4)		(4)		(12)		(12)

Periodic accrual adjustments	(15)	(23)	(50)	(65)
Ending Balance	\$ 46	\$ 74	\$ 46	\$ 74

7

## [Table of Contents](#)

**Income taxes:** We account for income taxes under the liability method. Deferred tax liabilities are recognized for temporary differences that will result in taxable amounts in future years. Deferred tax assets are recognized for deductible temporary differences and tax operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the periods in which the deferred tax asset or liability is expected to be realized or settled. We assess the likelihood that our deferred tax assets will be recovered from future taxable income and record a valuation allowance to reduce our deferred tax assets to the amounts we believe to be realizable. We concluded that a full valuation allowance against our U.S. deferred tax assets was appropriate as of October 2, 2010 and January 2, 2010.

**Share-based compensation:** We recognize share-based compensation expense on a straight-line basis over the vesting period for all 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 Board of Directors members, 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 \$143 and \$162 for the three months ended October 2, 2010 and October 3, 2009, respectively, and \$336 and \$445 for the nine months ended October 2, 2010 and October 3, 2009, respectively. We estimate that the remaining expense for fiscal 2010 and beyond will be approximately \$124 and \$186, respectively, based on the value of stock awards outstanding as of October 2, 2010. This estimate does not include any expense for additional awards that may be granted and vest during 2010.

**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.

A reconciliation of net income (loss) to comprehensive income (loss) is as follows:

	Three Months Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Net income (loss)	\$ 922	\$ 416	\$ 1,643	\$ (1,957)
Other comprehensive income (loss), net of tax:				
Effect of foreign currency translation adjustments	67	112	38	86
Total other comprehensive income, net of tax	67	112	38	86
Comprehensive income (loss)	989	528	1,681	(1,871)
Comprehensive loss (income) attributable to noncontrolling interest	(37)	—	63	—
Comprehensive income (loss) attributable to controlling interest	\$ 952	\$ 528	\$ 1,744	\$ (1,871)

**Revenue recognition:** We recognize revenue from appliance sales in the period the consumer purchases and pays for the appliance, net of an allowance for estimated returns. We recognize revenue from appliance recycling when we collect and process a unit. We recognize revenue from appliance replacements when we collect, process and replace the original unit. We recognize byproduct revenue upon shipment. We recognize revenue on extended warranties with retained service obligations on a straight-line basis over the period of the warranty. On extended warranty arrangements that we sell but others service for a fixed portion of the warranty sales price, we recognize revenue for the net amount retained at the time of sale of the extended warranty to the consumer. We include shipping and handling charges to customers in revenue, which are recognized in the period the consumer purchases and pays for delivery. Shipping and handling costs that we incur are included in cost of revenues.

**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

8

## [Table of Contents](#)

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 year. For the three and nine months ended October 2, 2010, we excluded 624 and 532, respectively, options and warrants from the diluted weighted average share outstanding calculation as the effect of these options and warrants is anti-dilutive. The effect of all options outstanding for the three and nine months ended October 3, 2009 was anti-dilutive.

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

	Three Months Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Numerator:				
Net income (loss) attributable to controlling interest	\$ 885	\$ 416	\$ 1,706	\$ (1,957)
Denominator:				
Weighted average shares outstanding — basic	5,493	4,578	5,191	4,578
Employee stock options	14	—	23	—
Stock warrants	179	—	186	—
Weighted average shares outstanding - diluted	5,686	4,578	5,400	4,578

Income (loss) per share:				
Basic	\$	0.16	\$	0.09
			\$	0.33
			\$	(0.43)
Diluted	\$	0.16	\$	0.09
			\$	0.32
			\$	(0.43)

#### 4. Sale-Leaseback Transaction

On September 25, 2009, we completed the sale-leaseback of our St. Louis Park building. The building is a 126,458-square-foot facility that includes our corporate office, a processing and recycling center, and an ApplianceSmart Factory Outlet store. Pursuant to the agreement entered into on August 11, 2009, we sold the St. Louis Park building for \$4,627, net of fees, and leased the building back over an initial lease term of five years. The sale of the building provided the Company with \$2,032 in cash after repayment of the \$2,595 mortgage. The sale-leaseback transaction resulted in an adjustment of \$2,191 to the net book value related to the land and building, and we recorded a deferred gain of \$2,436. Under the terms of the lease agreement, we are classifying the lease as an operating lease and amortizing the gain on a straight-line basis over five years. We amortized \$122 and \$366 of the deferred gain for the three months and nine months ended October 2, 2010, respectively. The deferred gain amortization is netted against rent expense as a component of sales, general and administrative expenses in the consolidated statement of operations.

#### 5. Investments in Joint Venture

On June 1, 2009, we completed a \$263 investment in Diagnostico y Administracion de Logistica Inversa, S.A. de C.V. ("DALI"), a Mexican company. DALI is a joint venture that operates a refrigerator recycling program sponsored by the Mexican government. Our investment represents a 32.7% ownership in the joint venture. The DALI joint venture is accounted for under the equity method and is presented in the consolidated balance sheets as a component of other assets. The results of the joint venture were immaterial for the three and nine months ended October 2, 2010 and October 3, 2009 and for the year ended January 2, 2010.

9

#### [Table of Contents](#)

#### 6. Variable Interest Entity

ARCA Advanced Processing, LLC ("AAP") is a joint venture that was formed in October 2009 between ARCA and 4301 Operations, LLC ("4301") to support ARCA's agreement with General Electric Company acting through its GE Consumer & Industrial business ("GE"). Both ARCA and 4301 have a 50% interest in AAP. GE sells all of its recyclable appliances generated in the northeastern 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. The term of the agreement is for six years from the first date of appliance collection, which was March 31, 2010. AAP commenced operations on February 8, 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.

The following table summarizes the assets and liabilities of the consolidated variable interest entity as of October 2, 2010:

<b>Assets</b>	
Current assets	\$ 410
Property and equipment	6,324
Other assets	685
	<u>\$ 7,419</u>
<b>Liabilities</b>	
Current liabilities (a)	\$ 2,772
Long-term debt obligations, net of current maturities	772
	<u>\$ 3,544</u>

(a) Current liabilities include an intercompany balance of \$1,694 that is eliminated in consolidation.

Revenues from our consolidated variable interest entity for the three and nine months ended October 2, 2010 were \$2,261 and \$4,832, respectively. Operating income (loss) from our consolidated variable interest entity for the three and nine months ended October 2, 2010 were \$89 and \$(93), respectively.

As of October 2, 2010, we contributed \$2,000 to AAP, which included \$375 we loaned to 4301 as of January 2, 2010. As of October 2, 2010, we had loaned AAP an additional \$1,694 which was used to support AAP's operations.

The financial position and results of operations for AAP are reported in our recycling segment. The purchase price has been allocated on a preliminary basis as we are still determining the fair value of certain property and equipment and intangible assets acquired.

The following table summarizes the allocation of the purchase price to the fair value of the assets acquired and liabilities assumed as a result of consolidating AAP as a variable interest entity.

	<b>February 8, 2010</b>
Current assets	\$ 35
Property and equipment	3,162
Other assets	761
Total assets acquired	3,958
Accounts payable	(302)
Debt obligations	(1,656)
Net assets acquired	2,000
Less cash acquired	(31)
Net cash paid	<u>\$ 1,969</u>

10

#### [Table of Contents](#)

## 7. Other Assets

Other assets consist of the following:

	October 2, 2010	January 2, 2010
Deposits	\$ 445	\$ 407
Investment in DALI	263	263
Loan to 4301 Operations, LLC	—	375
Recycling contract, net	439	479
Other	672	42
	<u>\$ 1,819</u>	<u>\$ 1,566</u>

## 8. Accrued Expenses

Accrued expenses consist of the following:

	October 2, 2010	January 2, 2010
Compensation and benefits	\$ 1,609	\$ 868
Accrued recycling incentive checks	1,232	1,232
Accrued rent	1,315	1,176
Warranty expense	46	67
Accrued payables	652	350
Current portion of deferred gain on sale-leaseback of building	487	488
Other	567	220
	<u>\$ 5,908</u>	<u>\$ 4,401</u>

## 9. Line of Credit

On August 30, 1996, we entered into a General Credit and Security Agreement, (“Credit Agreement”) as amended, with Spectrum Commercial Services (the “Lender”) that provides us with an \$18,000 line of credit. The outstanding balance under the Credit Agreement was \$12,692 as of October 2, 2010 with a stated interest rate of 6.75% (the greater of prime plus 3.50 percentage points or 6.75%). The outstanding balance under the Credit Agreement was \$12,419 as of January 2, 2010 with a stated interest rate of 6.25% (the greater of prime plus 3.00 percentage points or 6.25%). The amount of borrowings available under the Credit Agreement is based on a formula using receivables and inventories. Our unused borrowing capacity under the Credit Agreement was \$253 and \$56 as of October 2, 2010 and January 2, 2010, respectively. We may not have access to the full \$18,000 line of credit due to the formula using our receivables and inventories. The Credit Agreement has a stated maturity date of December 31, 2010, if not renewed, and provides that the Lender may demand payment in full of the entire outstanding balance of the loan at any time. The Credit Agreement is collateralized by substantially all our assets and requires minimum monthly interest payments of \$58, regardless of the outstanding principal balance. The Lender is also secured by an inventory repurchase agreement with Whirlpool Corporation for purchases from Whirlpool only. The Credit Agreement requires that we meet a minimum profitability covenant and a minimum tangible net worth covenant, provides payment penalties for noncompliance and prepayment, limits the amount of other debt we can incur, limits the amount of spending on fixed assets and prohibits payments of dividends. As of January 2, 2010, the outstanding balance was \$12,419 and we were in compliance with all covenants under the Credit Agreement, except the minimum profitability covenant and we received a waiver related to this covenant from the Lender. As of October 2, 2010, we were in compliance with all the covenants of the Credit Agreement.

## [Table of Contents](#)

## 10. Long-Term Obligations

Long-term debt and capital lease obligations consist of the following:

	October 2, 2010	January 2, 2010
6.85% mortgage, due in monthly installments of \$15, including interest, due January 2013, collateralized by land and building	\$ 1,529	\$ 1,586
Capital leases and other financing obligations (see below)	545	921
Debt obligations from the consolidation of AAP (see below)	956	—
	3,030	2,507
Less current maturities	586	544
	<u>\$ 2,444</u>	<u>\$ 1,963</u>

*Capital leases and other financing obligations:* We acquire certain equipment under capital leases and other financing obligations. The cost of the equipment was approximately \$1,609 and \$1,615 at October 2, 2010 and January 2, 2010, respectively. Accumulated amortization at October 2, 2010 and January 2, 2010 was approximately \$1,128 and \$802, respectively. Depreciation and amortization expense is included in cost of revenues and selling, general and administrative expenses.

*Debt obligations from the consolidation of AAP:* AAP has several debt obligations with maturity dates ranging from October 2010 to October 2024, interest rates ranging from 0% to 10% and monthly payments ranging from \$3 to \$10. One note is collateralized by substantially all of the assets of AAP.

## 11. 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.

## 12. Income Taxes

We recorded a provision for income taxes of \$166 and \$395 for the three and nine months ended October 2, 2010, respectively, primarily as a result of generating taxable income in our Canadian subsidiary. We recorded a provision for income taxes of \$150 and \$51 for the three and nine months ended October 3, 2009 primarily as the result of



taxable income in our Canadian subsidiary. We did not record a provision for or benefit from income taxes for our U.S. subsidiaries because we have available net operating losses to offset future taxable income and we have recorded full valuation allowances against our U.S. net deferred tax assets due to the uncertainty of their realization. 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 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 October 2, 2010 and January 2, 2010, 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 October 2, 2010 and January 2, 2010, 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

[Table of Contents](#)

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 2007. We are not currently under examination by any taxing jurisdiction.

We had no significant unrecognized tax benefits as of October 2, 2010 and January 2, 2010 that would reasonably be expected to affect our effective tax rate during the next twelve months.

**13. Shareholders' Equity**

*Common Stock:* In April 2010 we completed a private placement of 915 shares of our Common Stock at \$2.00 per share resulting in net proceeds of \$1,721. The net proceeds were used to capitalize and support AAP, which was formed to establish and operate our regional processing center in Philadelphia.

*Stock options:* Our 2006 Stock Option Plan (the "2006 Plan") permits the granting of incentive stock options meeting the requirements of Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified options that do not meet the requirements of Section 422. As of October 2, 2010, the 2006 Plan has 63 options remaining to grant from 600 options reserved under the plan. As of October 2, 2010, 522 options were outstanding to employees and non-employee directors and 15 options have been exercised 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 October 2, 2010, options to purchase an aggregate of 34 shares were outstanding under the 1997 Plan. Options granted to employees typically vest over two years while grants to non-employee directors vest in six months. During the second quarter of 2010, we granted 108 stock options with an exercise price of \$3.55 per share, vesting periods ranging from six months to one year and a weighted average fair value of \$3.08 per share. During the third quarter of 2010, we granted 35 stock options with an exercise price of \$2.30 per share, vesting period of one year and a fair value of \$1.94 per share.

*Warrants:* On October 21, 2009, we issued a warrant to GE to purchase 248 shares of Common Stock at a price of \$0.75 per share. The fair market value of the warrant issued was \$479 and is exercisable in full at any time during a term of ten years. The exercise price may be reduced and the number of shares of Common Stock that may be purchased under the warrant may be increased if the Company issues or sells additional shares of Common Stock at a price lower than the then-current warrant exercise price or the then-current market price of the Common Stock. The shares underlying the warrant include legal restrictions regarding the transfer or sale of the shares. As a result of our private placement offering in April 2010, the number of shares of Common Stock underlying the warrant increased to 254 shares and the exercise price decreased to \$0.73 per share as defined in the agreement. There was no accounting charge as a result of the change in warrant shares or exercise price due to the treatment of the warrant as permanent equity. On May 13, 2010, we issued warrants to non-employees to purchase 24 shares of Common Stock at a price of \$3.55 per share, vesting period of two years and a fair value of \$3.03 per share.

The following table summarizes the assumptions used to estimate the fair value of options and warrants granted during the second and third quarters of 2010 using the Black-Scholes Model:

	Q2 2010	Q3 2010
Expected dividend yield	0.0%	0.0%
Expected stock price volatility	105.5% - 119.9%	104.2%
Risk-free interest rate	3.0% - 3.6%	2.0%
Expected life of options	7 - 10 years	7 years

*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.

**14. 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 Factory Outlet 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

[Table of Contents](#)

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.

The following tables present our segment information for periods indicated:

Three Months Ended		Nine Months Ended	
October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009

<b>Revenues:</b>								
Retail	\$	17,114	\$	18,123	\$	57,517	\$	58,561
Recycling		10,224		7,882		25,298		18,994
<b>Total revenues</b>	<b>\$</b>	<b>27,338</b>	<b>\$</b>	<b>26,005</b>	<b>\$</b>	<b>82,815</b>	<b>\$</b>	<b>77,555</b>
<b>Operating income (loss):</b>								
Retail	\$	(197)	\$	(161)	\$	(201)	\$	(2,126)
Recycling		1,713		1,064		3,322		1,207
Unallocated corporate		(198)		(48)		(346)		(52)
<b>Total operating income (loss)</b>	<b>\$</b>	<b>1,318</b>	<b>\$</b>	<b>855</b>	<b>\$</b>	<b>2,775</b>	<b>\$</b>	<b>(971)</b>
<b>Assets:</b>								
Retail	\$	16,428	\$	19,693	\$	16,428	\$	19,693
Recycling		14,899		7,810		14,899		7,810
Corporate assets not allocable		9,425		5,880		9,425		5,880
<b>Total assets</b>	<b>\$</b>	<b>40,752</b>	<b>\$</b>	<b>33,383</b>	<b>\$</b>	<b>40,752</b>	<b>\$</b>	<b>33,383</b>
<b>Cash capital expenditures:</b>								
Retail	\$	26	\$	41	\$	58	\$	170
Recycling		1,392		5		2,808		9
Corporate assets not allocable		48		18		156		242
<b>Total cash capital expenditures</b>	<b>\$</b>	<b>1,466</b>	<b>\$</b>	<b>64</b>	<b>\$</b>	<b>3,022</b>	<b>\$</b>	<b>421</b>
<b>Depreciation and amortization:</b>								
Retail	\$	97	\$	108	\$	296	\$	315
Recycling		104		87		359		241
Unallocated corporate		136		142		407		429
<b>Total depreciation and amortization</b>	<b>\$</b>	<b>337</b>	<b>\$</b>	<b>337</b>	<b>\$</b>	<b>1,062</b>	<b>\$</b>	<b>985</b>
<b>Interest expense:</b>								
Retail	\$	185	\$	201	\$	546	\$	592
Recycling		50		55		152		165
Unallocated corporate		10		69		46		145
<b>Total interest expense</b>	<b>\$</b>	<b>245</b>	<b>\$</b>	<b>325</b>	<b>\$</b>	<b>744</b>	<b>\$</b>	<b>902</b>

## 15. Subsequent Events

In preparing the accompanying consolidated financial statements, the Company evaluated material subsequent events requiring recognition or disclosure herein and determined no such events existed.

## [Table of Contents](#)

### 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 the speed at which individual retail outlets reach profitability, the volume of appliance sales and the strength of energy conservation recycling programs. 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 January 2, 2010.

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 are in the business of selling new major household appliances through a chain of Company-owned factory outlet stores under the name ApplianceSmar<sup>®</sup>. We also provide turnkey appliance recycling and replacement services for electric utilities and other sponsors of energy efficiency programs.

**Subsidiaries.** ARCA Canada Inc., a Canadian corporation, is a wholly-owned subsidiary. ARCA Canada was formed in September 2006 to provide turnkey recycling services for electric utility energy efficiency programs. ARCA California, Inc., a California corporation, is a wholly-owned subsidiary. ARCA California was formed in November 1991 to provide turnkey recycling services for electric utility efficiency programs. The operating results of ARCA Canada and ARCA California have been consolidated in our financial statements.

**Joint Ventures.** On June 1, 2009, we completed a \$0.3 million investment in Diagnostico y Administracion de Logistica Inversa, S.A. de C.V. ("DALI"), a Mexican company. DALI is a joint venture that operates a refrigerator recycling program sponsored by the Mexican government. Our investment represents a 32.7% ownership in the joint venture. The DALI joint venture is accounted for under the equity method and is presented in the consolidated balance sheets as a component of other assets. The results of the joint venture were immaterial for the three and nine months ended October 2, 2010 and October 3, 2009 and for the year ended January 2, 2010. We are in the process of evaluating the long-term prospects and strategic importance of the investment as it relates to the current recycling program sponsored by the Mexican government.

On October 21, 2009, we entered into a Joint Venture Agreement with 4301 Operations, LLC, (“4301”) to establish and operate a Regional Processing Center (“RPC”) in Philadelphia. 4301 has substantial experience in the recycling of major household appliances and contributed its existing business to the joint venture. Under the Joint Venture Agreement, the parties formed an entity known as ARCA Advanced Processing, LLC (“AAP”) and each party has a 50% interest in the entity. AAP has the exclusive rights as a subcontractor to service our GE agreement. The GE agreement is contingent on our ability to raise additional financing to purchase and install UNTHA Recycling Technology (“URT”) equipment, which will enhance the capabilities of the RPC. We are the exclusive distributor of URT equipment for North America. The joint venture plans to raise additional debt financing to purchase the URT equipment, but there is no assurance that the financing will be available or on terms acceptable to the joint venture.

## [Table of Contents](#)

AAP commenced operations on February 8, 2010 and collected the first load of recyclable appliances from GE on March 31, 2010. As of October 2, 2010, we had invested \$2.0 million in AAP, which included \$0.4 million we loaned to 4301 as of January 2, 2010. As of October 2, 2010, we had loaned AAP an additional \$1.7 million which was used to support AAP’s operations. 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.

**Reporting Period.** Operating results for the three- and nine-month periods ended October 2, 2010 and October 3, 2009 are presented using 13- and 39-week periods, respectively. The results of operations for any interim period are not necessarily indicative of the results for the year.

### Key Components of Results of Operations

**Revenues.** We generate revenues from three sources: retail, recycling and byproduct. Retail revenues are generated through the sale of new appliances at our ApplianceSmart Factory Outlet stores. Recycling revenues are generated by charging fees for collecting and recycling appliances for utilities and other sponsors of energy efficiency programs. Recycling revenues also include fees charged for recycling and replacing old refrigerators with new energy efficient refrigerators for low-income housing programs sponsored by electric utilities. Byproduct revenues are generated by selling recovered materials, such as metals and plastics, and reclaimed chlorofluorocarbons (“CFC”) refrigerants, from appliances we collect and recycle, including appliances from our ApplianceSmart Factory Outlet stores and AAP.

**Cost of Revenues.** Cost of revenues includes all costs related to the purchase of inventory, including freight, costs related to receiving and distribution of inventory, and costs related to delivery and service of inventory after it is sold to the consumer. The costs related to recycling appliances, such as customer service, transportation and processing, and the cost of refrigerators purchased for our replacement programs, are included in the cost of revenues. Depreciation expense related to buildings and equipment from our recycling centers is presented in cost of revenues.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses are comprised primarily of employee compensation and benefits (including share-based compensation), occupancy costs, advertising, bank processing charges, professional services and depreciation.

**Interest Expense.** Interest expense is comprised of interest charges related to borrowings under our line of credit, our mortgage on our California building and other long-term obligations, primarily capital leases and debt obligations of AAP. In September 2009, we paid off the mortgage on our Minnesota building in connection with the sale-leaseback of the property.

**Segments.** We operate two reportable segments: retail and recycling. The retail segment is comprised of income generated through our ApplianceSmart Factory Outlet stores. Our 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. Retail revenues typically have lower profit margins than recycling revenues.

**Retail Segment.** We operated nineteen factory outlet stores as of October 2, 2010 and eighteen factory outlet stores as of October 3, 2009. We believe our nineteen factory outlet stores are located in convenient, high-traffic locations in Georgia, Minnesota, Ohio and Texas. In November 2009, we opened one new factory outlet store in Cumming, Georgia, and in August 2009, terminated the lease and closed one store in Stockbridge, Georgia, and closed one store in San Antonio, Texas, when the lease expired.

**Recycling Segment.** We operate eight processing and recycling centers, which are located in Minnesota, California, Texas, Illinois, Colorado, Washington, North Carolina and Ontario, Canada. The regional processing center in Philadelphia, Pennsylvania, operated by AAP is also included in our recycling segment.

## [Table of Contents](#)

### Results of Operations

The following table sets forth our consolidated operating results for the periods indicated as a percentage of total revenues:

	Three Months Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	67.6	67.3	69.1	71.1
Gross profit	32.4	32.7	30.9	28.9
Selling, general and administrative expenses	27.6	29.4	27.5	30.1
Operating income (loss)	4.8	3.3	3.4	(1.2)
Other income (expense):				
Interest expense, net	(0.9)	(1.2)	(0.9)	(1.2)
Other income (expense), net	0.1	0.1	0.0	(0.0)
Income (loss) before income taxes and noncontrolling interest	4.0	2.2	2.5	(2.4)
Provision for income taxes	0.6	0.6	0.5	0.1
Net income (loss)	3.4	1.6	2.0	(2.5)
Net loss (income) attributable to noncontrolling interests	(0.1)	0.0	0.1	0.0
Net income (loss) attributable to controlling interests	3.3%	1.6%	2.1%	(2.5)%

For the Three Months Ended October 2, 2010 and October 3, 2009

The following table sets forth the key results of operations by segment for the three months ended October 2, 2010 and October 3, 2009 (dollars in millions):

	2010	2009	% Change
<b>Revenues:</b>			
Retail	\$ 17.1	\$ 18.1	(5.6)%
Recycling	10.2	7.9	29.7%
Total revenues	<u>\$ 27.3</u>	<u>\$ 26.0</u>	5.1%
<b>Operating income (loss):</b>			
Retail	\$ (0.2)	\$ (0.2)	(22.4)%
Recycling	1.7	1.1	61.0%
Unallocated corporate costs	(0.2)	—	(312.5)%
Total operating income (loss)	<u>\$ 1.3</u>	<u>\$ 0.9</u>	54.2%

**Revenues.** Revenues for the three months ended October 2, 2010 and October 3, 2009 are as follows (dollars in millions):

	2010	2009	% Change
Retail	\$ 16.8	\$ 18.0	(6.6)%
Recycling	6.5	7.0	(6.6)%
Byproduct	4.0	1.0	287.9%
	<u>\$ 27.3</u>	<u>\$ 26.0</u>	5.1%

Our total revenues for the third quarter ended October 2, 2010 increased \$1.3 million or 5.1% from \$26.0 million in the third quarter of 2009. Retail segment revenues accounted for 62.6% of total revenues in the third quarter of 2010 compared to 69.7% in the third quarter of 2009. The increase in third quarter 2010 revenues was attributed primarily to the addition of new recycling contracts and the inclusion of revenues from AAP. In the third quarter of 2010, retail segment revenues decreased 5.6% to \$17.1 million compared to \$18.1 million in the third quarter of 2009. Recycling segment revenues in the

17

## [Table of Contents](#)

third quarter of 2010 increased 29.7% to \$10.2 million compared to \$7.9 million in the third quarter of 2009. Recycling segment revenues and retail segment revenues each include a portion of byproduct revenues.

**Retail Revenues.** Our retail revenues of \$16.8 million for the third quarter of 2010 decreased \$1.2 million or 6.6% from \$18.0 million in the third quarter of 2009. Our comparable store revenues for the eighteen factory outlets stores that were open during the entire third quarters of 2010 and 2009 were down 6.8% or \$1.1 million. The decrease in comparable store revenues was due primarily to lower unit sales in Ohio and Minnesota. For these two markets, we have experienced fewer sales of complete kitchen and laundry sets. Consumer buying habits have changed to purchasing and replacing single units as a result of the weak economy. We do not expect to open any additional factory outlet stores or experience significant changes in sales volumes or retail prices over the remainder of 2010. We continue to evaluate factory outlet stores and markets and address underperforming stores with a range of possible actions from expense reductions to store closings.

**Recycling Revenues.** Our recycling revenues of \$6.5 million, which include appliance recycling fees and low-income appliance replacement program revenues, decreased \$0.5 million or 6.6% for the third quarter of 2010 from \$7.0 million in the third quarter of 2009. Appliance recycling fees of \$6.0 million increased \$0.7 million for the third quarter of 2010 compared to \$5.3 million in the third quarter of 2009 due primarily to new contracts added during the past twelve months, which increased the volume of appliances recycled by approximately 6% and increased the per unit fee by 10%. Replacement program revenues decreased \$1.2 million, primarily as the result of lower volumes, which were expected, for a California utility customer's replacement program. This represents a decrease of approximately 79.2% in volume for the third quarter of 2010 compared to the third quarter of 2009. We expect that the lower volumes will continue throughout the remainder of 2010. We are pursuing new appliance recycling and replacement programs but cannot predict if we will be successful in signing new contracts or renewing existing contracts.

**Byproduct Revenues.** Our byproduct revenues of \$4.0 million for the third quarter of 2010 increased \$3.0 million or 287.9% from \$1.0 million in the third quarter of 2009. The increase was due primarily to higher scrap metal prices and the impact of AAP on our consolidated results. AAP generated \$2.3 million in revenues during the third quarter of 2010. At the end of the third quarter 2010, AAP was servicing all distribution centers in GE's northeastern region under the GE contract. We expect byproduct revenues to increase throughout 2010 as a result of strong recycling activity during the holiday season in our Philadelphia processing center operated by AAP.

**Gross Profit.** Our overall gross profit of \$8.9 million in the third quarter 2010 increased \$0.4 million or 4.3% from \$8.5 million in the third quarter of 2009. Our gross profit as a percentage of total revenues for the third quarter of 2010 was 32.4% compared to 32.7% in the third quarter of 2009. The overall gross profit was partially offset by higher operating costs related to the ramp-up of production at AAP. Excluding AAP, overall gross profit as a percentage of total revenues increased to 34.7%. The increase, excluding AAP, was due to several factors, including higher recycling revenues from new contracts, strong management of operating costs, better pricing from our manufacturers and improved operational efficiencies. The gross profit percentage for the retail segment was 29.7% in the third quarter of 2010 compared to 28.4% in the same quarter of 2009. The year-over-year increase was related primarily to better pricing from our manufacturers and operational efficiencies. The majority of this improvement or one basis point is attributable to manufacturer pricing improvements and the balance is the result of on-going operational efficiencies. The gross profit percentage for the recycling segment decreased to 37.0% in the third quarter of 2010 compared to 42.5% for the same quarter of 2009, primarily related to higher operating costs due to the ramp-up of productions at AAP. Excluding AAP, the third quarter 2010 recycling segment gross profit percentage increased to 45.6%, due primarily to new recycling programs in Minnesota, New York, North Carolina and Washington along with on-going operational efficiencies and cost reduction measures that contributed to a \$0.3 million increase in recycling gross profit. We expect gross profit to improve over the remainder of 2010 as the Philadelphia processing center ramps up for the fourth quarter holiday season.

**Selling, General and Administrative Expenses.** Our selling, general and administrative ("SG&A") expenses of \$7.5 million for the third quarter of 2010 decreased \$0.1 million or 1.2% from \$7.6 million in the third quarter of 2009. Our SG&A expenses as a percentage of total revenues for the third quarter of 2010 were 27.6% compared to 29.4% for the third quarter of 2009. Selling expenses decreased \$0.3 million to \$4.8 million in the third quarter of 2010 from \$5.1 million in the third quarter of 2009. The decrease in selling expenses was due primarily to lower retail store operating costs as a result of closing two underperforming factory outlet stores in August 2009 and streamlining our retail management structure. General and administrative expenses increased \$0.2 million to \$2.8 million in the third quarter of 2010 from \$2.6 million in the third quarter of 2009. The increase in general and administrative expenses is due primarily to the impact of AAP. We expect SG&A expenses to increase throughout 2010 as AAP ramps up the Philadelphia processing center.

18

## [Table of Contents](#)

**Interest Expense.** Interest expense decreased \$0.1 million in the third quarter of 2010 compared to the third quarter of 2009 primarily as a result of reducing the weighted-average balance on our line of credit and paying off the mortgage on our St. Louis Park, Minnesota, facility in connection with the sale-leaseback transaction in

September 2009. We cannot predict what will happen with the weighted-average balance on our line of credit and the associated floating interest rate throughout the remainder of 2010 and 2011.

**Provision for Income Taxes.** We recorded a provision for income taxes of \$0.2 million and \$0.2 million in the third quarter of 2010 and 2009, respectively, primarily as a result of generating taxable income in our Canadian subsidiary. We did not record a provision for or benefit from income taxes for our U.S. subsidiaries because we have available net operating losses to offset future taxable income and we have recorded a full valuation allowance against our U.S. net deferred tax assets due to the uncertainty of their realization. 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.

**Noncontrolling Interest.** Noncontrolling interest represents 4301's share of AAP's net income. Under the AAP Joint Venture Agreement, ARCA and 4301 each have a 50% interest in AAP. AAP reported net income of \$75,000 in the third quarter of 2010, of which \$37,000 represented the noncontrolling interest.

#### For the Nine Months Ended October 2, 2010 and October 3, 2009

The following table sets forth the key results of operations by segment for the nine months ended October 2, 2010 and October 3, 2009 (dollars in millions):

	2010	2009	% Change
<b>Revenues:</b>			
Retail	\$ 57.5	\$ 58.6	(1.8)%
Recycling	25.3	19.0	33.2%
Total revenues	<u>\$ 82.8</u>	<u>\$ 77.6</u>	6.8%
<b>Operating income (loss):</b>			
Retail	\$ (0.2)	\$ (2.1)	90.5%
Recycling	3.3	1.2	175.2%
Unallocated corporate costs	(0.3)	(0.1)	(565.4)%
Total operating income (loss)	<u>\$ 2.8</u>	<u>\$ (1.0)</u>	385.8%

**Revenues.** Revenues for the nine months ended October 2, 2010 and October 3, 2009 are as follows (dollars in millions):

	2010	2009	% Change
Retail	\$ 56.5	\$ 58.2	(3.0)%
Recycling	17.2	17.0	1.3%
Byproduct	9.1	2.4	283.7%
	<u>\$ 82.8</u>	<u>\$ 77.6</u>	6.8%

Our total revenues of \$82.8 million for the nine months ended October 2, 2010 increased \$5.2 million or 6.8% from \$77.6 million in the same period of 2009. Retail segment revenues accounted for 69.5% of total revenues for the nine months ended October 2, 2010 compared to 75.5% in the same period of 2009. The increased revenues are attributed primarily to the impact of AAP and revenue growth from our new recycling contracts. For the nine months ended October 2, 2010, retail segment revenues decreased 1.8% to \$57.5 million compared to \$58.6 million the same period of 2009. Recycling segment revenues for the nine months ended October 2, 2010 increased 33.2% to \$25.3 million compared to \$19.0 million in the same period of 2009. Recycling segment revenues and retail segment revenues each include a portion of byproduct revenues.

**Retail Revenues.** Our retail revenues of \$56.5 million for the nine months ended October 2, 2010 decreased \$1.7 million or 3.0% from \$58.2 million in the same period of 2009. The decrease in retail revenues was due primarily to lower comparable store revenues and the closing of two underperforming factory outlet stores in August 2009. For the nine months ended October 2, 2010, the net effect of store openings and closings resulted in a \$0.7 million decrease in retail

#### [Table of Contents](#)

revenues as compared to the same period of 2009. Our comparable store revenues of the eighteen factory outlets stores that were open during the same year-to-date periods of 2010 and 2009 were down 1.9% or \$1.0 million. The decrease in comparable store revenues was due primarily to lower unit sales in our Minnesota, Ohio and Georgia markets. For these markets, we have experienced fewer sales of complete kitchen and laundry sets. Consumer buying habits have changed to purchasing and replacing single units as a result of the weak economy. We do not expect to open any additional factory outlet stores or experience significant changes in sales volumes or retail prices over the remainder of 2010. We continue to evaluate factory outlet stores and markets and address underperforming stores with a range of outcomes from expense reductions to store closings.

Our factory outlets carry a wide range of new in-the-box and new out-of-the-box appliances, including manufacturer closeouts, factory overruns, floor samples, returned or exchanged items, open-carton items, and scratch and dent appliances.

We continue to purchase the majority of new in-the-box and new out-of-the-box appliances from Whirlpool, GE and Electrolux. We have no minimum purchase requirements with any of these manufacturers. We believe purchases from these three manufacturers will provide an adequate supply of high-quality appliances for our retail factory outlets; however, there is a risk that one or more of these sources could be curtailed or lost.

**Recycling Revenues.** Our recycling revenues of \$17.2 million, which include appliance recycling fees and low-income appliance replacement program revenues, increased \$0.2 million or 1.3% for the nine months ended October 2, 2010 from \$17.0 million in the same of 2009. Appliance recycling fees of \$14.5 million for the nine months ended October 2, 2010 increased \$2.9 million or 24.6% compared to \$11.6 million in the same period of 2009, due primarily to the recycling contracts added during the past twelve months. Replacement program revenues decreased \$2.6 million, primarily as the result of lower volumes for a California utility customer's replacement program. This represents a decrease of approximately 50.7% in volume for the nine months ended October 2, 2010 compared to the same period of 2009. Even though the California utility sponsoring the replacement program reduced its marketing outreach to potential participants in 2010, resulting in an overall decrease in customer enrollment and corresponding revenues, the program generated \$2.7 million for the nine months ended October 2, 2010. In the October 2010, we re-signed a multi-year contract with the California utility sponsoring the appliance replacement program and expect to start building revenues in 2011. We are pursuing new appliance recycling and replacement programs but cannot predict if we will be successful in signing new contracts or renewing existing contracts.

**Byproduct Revenues.** Our byproduct revenues of \$9.1 million for the nine months ended October 2, 2010 increased \$6.7 million or 283.7% from \$2.4 million for the same period of 2009. The increase was due primarily to the impact of AAP in our consolidated results and to a lesser extent higher scrap metal prices and recycling volumes. Byproduct revenues have improved approximately 30% to 40%, depending on geographic region, compared to the prior year which had a positive impact on our recycling gross profit. AAP commenced operations in February 2010 and has generated \$4.8 million in byproduct revenues. We expect byproduct revenues to increase throughout 2010 as a result of strong recycling activity during the holiday season in our Philadelphia processing center operated by AAP.

**Gross Profit.** Our overall gross profit of \$25.6 million for the nine months ended October 2, 2010 increased \$3.2 million or 14.1% from \$22.4 million for the same period of 2009. Our gross profit as a percentage of total revenues for the nine months ended October 2, 2010 was 30.9%, or 32.7% excluding AAP, compared to 28.9% for the same period of 2009. The increase, excluding AAP, was due to several factors, including, stronger byproduct revenues, better pricing from manufacturers and improved operational efficiencies. The gross profit percentage for the retail segment was 28.8% for the nine months ended October 2, 2010 compared to 26.8% for the same period of 2009. The year-over-year increase was related primarily to better pricing from manufacturers and operational efficiencies. Better pricing from manufacturers contributed to a one basis point improvement and the remainder of the improvement was the result of cost reductions in delivery and shipping. The gross profit percentage for the recycling segment was 35.5% for the nine months ended October 2, 2010 compared to 35.4% for the same period of 2009. The recycling segment gross profit was partially offset by higher operating costs related to the ramp-up of production at AAP. Excluding AAP, the recycling segment gross profit percentage increased to 43.4%, primarily as a result of new recycling programs in Minnesota, New York, North Carolina and Washington along with on-going operational efficiencies and cost reduction measures that contributed to a \$2.1 million increase in recycling gross profit. We expect gross profit to improve over the remainder of 2010 as the Philadelphia processing center ramps up for the fourth quarter holiday season. Recycling gross profit percentages are typically higher than retail gross profit percentages. Our retail margins on out-of-the box product are typically higher than in-the-box product. Our gross profit as a percentage of total revenues for future periods can be affected favorably or unfavorably by numerous factors, including:

20

---

[Table of Contents](#)

1. The mix of retail products we sell.
2. The prices at which we purchase product from the major manufacturers who supply product to us.
3. The volume of appliances we receive through our recycling contracts.
4. The volume and price of scrap metals, plastics and reclaimed CFCs.

**Selling, General and Administrative Expenses.** Our selling, general and administrative (“SG&A”) expenses of \$22.8 million for the nine months ended October 2, 2010 decreased \$0.6 million or 2.5% from \$23.4 million for the same period of 2009. Our SG&A expenses as a percentage of total revenues for the nine months ended October 2, 2010 were 27.5% compared to 30.1% for the same period of 2009. Selling expenses decreased \$0.9 million to \$15.1 million for the nine months ended October 2, 2010 from \$16.0 million for the same period of 2009. The decrease in selling expenses was due primarily to lower retail store operating costs as a result of closing two underperforming stores in August 2009 and streamlining our retail management structure. General and administrative expenses of \$7.7 million for the nine months ended October 2, 2010 increased \$0.3 million from \$7.4 million for the same period of 2009. The increase was due primarily to the impact of AAP. We expect SG&A expenses to decrease as a percentage of total revenues throughout 2010 as revenues ramp up under our GE contract.

**Interest Expense.** Interest expense decreased \$0.2 million for the nine months ended October 2, 2010 compared to the same period of 2009 primarily as a result of reducing the weighted-average balance on our line of credit and paying off the mortgage on our St. Louis Park, Minnesota, facility in connection with the sale-leaseback transaction in September 2009. We cannot predict what will happen with the weighted-average balance on our line of credit and the associated floating interest rate throughout the remainder of 2010 and 2011.

**Provision for Income Taxes.** We recorded a provision for income taxes of \$0.4 million and \$0.1 million for the nine months ended October 2, 2010 and October 3, 2009, respectively, primarily as a result of generating taxable income in our Canadian subsidiary. We did not record a provision for or benefit from income taxes for our U.S. subsidiaries because we have available net operating losses to offset future taxable income and we have recorded a full valuation allowance against our U.S. net deferred tax assets due to the uncertainty of their realization. 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.

**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 for the nine months ended October 2, 2010 of \$125,000, of which \$63,000 represented the noncontrolling interest.

**Liquidity and Capital Resources**

**Principal Sources and Uses of Liquidity.** Our principal sources of liquidity are cash from operations and borrowings under our line of credit. Our principal liquidity requirements consist of long-term debt and capital lease obligations, capital expenditures and working capital. Our cash and cash equivalents as of October 2, 2010 were \$3.9 million compared to \$2.8 million as of January 2, 2010. Our working capital balance at October 2, 2010 was consistent with the \$3.7 million of working capital at January 2, 2010.

**Sale of Common Stock.** In April 2010, we completed a private placement of 915,000 shares of our Common Stock at \$2.00 per share, resulting in net proceeds of \$1.7 million. The net proceeds were used to capitalize and support AAP, which was formed to establish and operate the RPC in Philadelphia.

**Net Cash Provided by Operating Activities.** Our net cash provided by operating activities was \$3.2 million for the nine months ended October 2, 2010 compared to \$1.5 million for the same period of 2009. The increase in cash provided by operating activities was due primarily to generating net income of \$1.6 million for the nine months ended October 2, 2010 compared to a net loss of \$2.0 million for the same period of 2009.

**Net Cash Provided by (Used in) Investing Activities.** Our net cash used in investing activities was \$3.0 million for the nine months ended October 2, 2010 compared to cash provided by investing activities of \$3.3 million for the same period of 2009. Net cash used in investing activities for the nine months ended October 2, 2010 was primarily related to our cash investment in AAP of \$2.0 million and our short-term note to AAP of \$1.7 million which was used by AAP as a \$2.7 million nonrefundable down payment on the purchase and installation of URT equipment to be installed at the RPC operated by AAP. We reported the \$2.7 million nonrefundable down payment as a component of purchases of property and

21

---

[Table of Contents](#)

equipment in the consolidated statement of cash flows. The remainder of the \$1.0 million investment was used to fund working capital and is included in the change in operating assets and liabilities in the consolidated statement of cash flows. During the first quarter of 2010, we converted \$0.4 million of loans previously made to 4301 Operations to capital contributions in AAP. The balance due on the URT equipment is expected to be approximately \$1.1 million depending on the fluctuation of the Euro against the U.S. dollar. AAP plans to raise additional debt financing to purchase the URT equipment, but there is no assurance that the financing will be available or on terms acceptable to the joint venture. The net cash provided by investing activities for the nine months ended October 3, 2009 was due primarily to selling our St. Louis Park building for \$4.6 million. The cash provided by selling the St. Louis Park building was partially offset by \$0.7 million related to a reserve account required by our bankcard processor, a \$0.3 million investment in DALI that was completed on June 1, 2009 and \$0.4 million related to purchases of property and equipment.

**Net Cash Provided by (Used in) Financing Activities.** Our net cash provided by financing activities was \$0.9 million for the nine months ended October 2, 2010 compared to \$5.6 million used in financing activities for the same period of 2009. Net cash provided by financing activities for the nine months ended October 2, 2010 was primarily due to the issuance of 915,000 shares of Common Stock that provided net proceeds of \$1.7 million and was partially offset by payments on our long-term debt obligations. The net cash used in financing activities for the nine months ended October 3, 2009 was due primarily to net payments on our line of credit, paying off our adjustable rate mortgage in conjunction with the sale of the St. Louis Park building and payments on our long-term obligations.

**Outstanding Indebtedness.** On August 30, 1996, we entered into a General Credit and Security Agreement, (“Credit Agreement”) as amended, with Spectrum Commercial Services (the “Lender”) that provides us with an \$18 million line of credit. The outstanding balance under the Credit Agreement was \$12.7 million as of October 2, 2010 with a stated interest rate of 6.75% (the greater of prime plus 3.50 percentage points or 6.75%). The outstanding balance under the Credit Agreement was \$12.4 million as of January 2, 2010 with a stated interest rate of 6.25% (the greater of prime plus 3.00 percentage points or 6.25%). The amount of borrowings available under the Credit Agreement is based on a formula using receivables and inventories. Our unused borrowing capacity under the Credit Agreement was \$0.3 million and \$0.1 million as of October 2, 2010 and January 2, 2010, respectively. We may not have access to the full \$18 million line of credit due to the formula using our receivables and inventories. The Credit Agreement has a stated maturity date of December 31, 2010, if not renewed, and provides that the Lender may demand payment in full of the entire outstanding balance of the loan at any time. The Credit Agreement is collateralized by substantially all our assets and requires minimum monthly interest payments of \$58,000, regardless of the outstanding principal balance. The Lender is also secured by an inventory repurchase agreement with Whirlpool Corporation for purchases from Whirlpool only. The Credit Agreement requires that we meet a minimum profitability covenant and a minimum annual tangible net worth covenant, provides payment penalties for noncompliance and prepayment, limits the amount of other debt we can incur, limits the amount of spending on fixed assets and prohibits payments of dividends.

The following summarizes our financial covenants under the Credit Agreement:

- 1) A minimum profitability covenant that requires the Company to report \$1 of net income for all quarterly periods between Q1 2008 and Q4 2010.
- 2) A minimum annual tangible net worth covenant that requires the Company to report a tangible net worth of \$2.9 million plus the annual net income, if applicable, for the fiscal years 2008 and 2009 and \$3.0 million plus the annual net income, if applicable, for fiscal year 2010.

As of October 2, 2010, we were in compliance with all the covenants of the Credit Agreement. As of January 2, 2010, the outstanding balance was \$12.4 million and we were compliance with all covenants of the Credit Agreement except the minimum profitability covenant and we received a waiver related to this covenant from the Lender.

[Table of Contents](#)

The following table illustrates our covenant compliance for the nine months ended October 2, 2010 and the fiscal year ended January 2, 2010:

Covenant/Period	Actual	Required	Covenant Waived	Outstanding Balance
<b>Profitability</b>				
Q1 2009	\$ (1,962,000)	\$ 1	Yes	\$ 11,381,000
Q2 2009	(411,000)	1	Yes	12,361,000
Q3 2009	416,000	1	n/a	n/a
Q4 2009	(1,381,000)	1	Yes	12,419,000
Q1 2010	102,000	1	n/a	n/a
Q2 2010	719,000	1	n/a	n/a
Q3 2010	885,000	1	n/a	n/a
<b>Tangible Net Worth</b>				
Fiscal Year 2009	\$ 3,241,000	\$ 2,900,000	n/a	n/a

As of October 2, 2010, we had debt obligations of \$2.1 million consisting of a mortgage on our California building along with various financings, consisting primarily of capital leases. As a result of consolidating the results of AAP, we also included \$1.0 million of AAP’s debt obligations with maturity dates ranging from October 2010 to October 2024, interest rates ranging from 0% to 10% and monthly payments ranging from \$3 to \$10.

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 current line of credit will be sufficient to finance our operations, long-term debt obligations and capital expenditures through at least the next twelve months. Our total capital requirements for 2010 and 2011 will depend upon, among other things as discussed below, the number and size of retail stores operating during the fiscal year, the recycling volumes generated from recycling contracts in 2010 and 2011 and our needs related to the establishment of ARCA Advanced Processing, LLC. AAP plans to raise additional debt financing to purchase the URT equipment, but there is no assurance that the financing will be available or on terms acceptable to the joint venture. Currently, we have nineteen retail stores and nine recycling centers in operation, including the regional processing center operated by AAP. 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 current debt agreement.

**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, since our interest rate floats with prime. The outstanding balance on our line of credit as of October 2, 2010 was approximately \$12.7 million. Although the \$12.7 million line of credit is subject to a minimum interest rate of 6.75%, based on average floating rate borrowings of \$12.7 million, a hypothetical 100 basis point change in the applicable interest rate would have caused our interest expense to change by an immaterial amount and \$0.1 million for the three and nine months ended October 2, 2010, 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 overall strength of 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 October 2, 2010. 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.

[Table of Contents](#)

**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 October 2, 2010. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, at October 2, 2010, 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 2010, 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.

#### [Table of Contents](#)

### **PART II. Other Information**

#### **Item 1. Legal Proceedings**

In December 2004, we filed a lawsuit in the U.S. District Court for the Central District of California alleging that JACO Environmental, Inc. ("JACO") and one of our former consultants fraudulently obtained U.S. Patent No. 6,732,416 in May 2004 covering appliance recycling methods and systems which were originally developed by us beginning in 1987 and used in serving more than forty-five electric utility appliance recycling programs up to the time the suit was filed. We sought an injunction to prevent JACO from claiming that it obtained a valid patent on appliance recycling processes that we believe is based on methods and processes we invented. In addition, we asked the Court to find that the patent obtained by JACO is unenforceable due to inequitable conduct before the United States Patent Office. We also asked the Court for unspecified damages related to charges that JACO, in using the patent to promote its services, engaged in unfair competition and false and misleading advertising under federal and California statutes. The defendants in the case did not assert any counterclaims against ARCA.

In September 2005, we received a legally binding document in which JACO stated it would not sue us or any of our customers for violating the JACO patent.

In January 2009, the Court granted JACO a summary judgment with respect to ARCA's claims of unfair competition and false and misleading advertising. Even though the Court's ruling had no impact on ARCA's method of recycling or ability to conduct existing and future business, we filed an appeal with the Ninth Circuit Court of Appeals in California in February 2009 seeking to have the Court set aside the summary judgment. On May 4, 2010, the Court entered an order affirming the summary judgment granted to JACO.

In December 2009, a lawsuit was commenced against us in the Fourth Judicial District Court of Hennepin County, Minnesota by RKL Landholdings, LLC and Emad Y. Abed ("Plaintiffs"), alleging that we breached an agreement to sell our St. Louis Park, Minnesota property to the Plaintiffs. We sold this property to a third party in September 2009, have received the proceeds from the sale, and are currently leasing the property from such third party. Edward Cameron, our Chief Executive Officer, was also named as a defendant in the lawsuit. The Plaintiff's claims were based on a Purchase Agreement and extensions thereto between the Plaintiffs and us, which Purchase Agreement and extensions had expired by their own terms. The Plaintiffs asserted various claims, including promissory estoppel, unjust enrichment, conversion, fraud, tortious interference with prospective advantage, and breach of contract. On August 6, 2010, the Hennepin County District Court entered a summary judgment in favor of Mr. Cameron and us and dismissed all of Plaintiffs' claims. The Plaintiffs have appealed the Court's ruling and we believe the summary judgment will be upheld on appeal.

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.

#### [Table of Contents](#)

### **Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
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.

---

\* Filed herewith.



[Table of Contents](#)

**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 15, 2010

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.  
(Registrant)

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

By /s/ Peter P. Hausback  
Peter P. Hausback  
Executive Vice President, Chief Financial Officer  
and Principal Accounting Officer

## 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. The registrant's other certifying officer(s) and I are 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. The registrant's other certifying officer(s) and 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 15, 2010

/s/Edward R. Cameron

Edward R. Cameron  
President and Chief Executive Officer

---

## CERTIFICATIONS:

I, Peter P. Hausback, 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. The registrant's other certifying officer(s) and I are 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. The registrant's other certifying officer(s) and 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 15, 2010

/s/Peter P. Hausback

Peter P. Hausback  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting 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 October 2, 2010 (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.

Dated: November 15, 2010

/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 October 2, 2010 (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.

Dated: November 15, 2010

/s/Peter P. Hausback  
Peter P. Hausback  
Executive Vice President and Chief Financial Officer  
Principal Financial and Accounting 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.

---