ELECTRONIC ARTS INC.
Form 10-K
May 28, 2010
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended March 31, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File No. 0-17948

ELECTRONIC ARTS INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-2838567**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
209 Redwood Shores Parkway Redwood City, California	**94065**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:

(650) 628-1500

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $0.01 par value	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.   Yes þ   No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.   Yes ¨   No þ

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 þ   No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).   Yes þ   No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.   þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer,   accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	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 Exchange Act).   Yes ¨   No þ

The aggregate market value of the registrant s common stock, $0.01 par value, held by non-affiliates of the registrant as of October 2, 2009, the last business day of our second fiscal quarter, was $5,931,009,000.

As of May 21, 2010 there were 329,676,985 shares of the registrant s common stock, $0.01 par value, outstanding.

Documents Incorporated by Reference

Portions of the registrant s definitive proxy statement for its 2010 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

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ELECTRONIC ARTS INC.

2010 FORM 10-K ANNUAL REPORT

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CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, made in this Report are forward looking. Examples of forward-looking statements include statements related to industry prospects, our future economic performance including anticipated revenues and expenditures, results of operations or financial position, and other financial items, our business plans and objectives, including our intended product releases, and may include certain assumptions that underlie the forward-looking statements. We use words such as anticipate, believe, expect, intend, estimate (and the negative of any of these terms), future and similar expressions to help identify forward-looking statements. These forward-looking statements are subject to business and economic risk and reflect management s current expectations, and involve subjects that are inherently uncertain and difficult to predict. Our actual results could differ materially from those in the forward-looking statements. We will not necessarily update information if any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect our future results include, but are not limited to, those discussed under the heading Risk Factors, beginning on page 15.

PART I

Item 1: ***Business***

We develop, market, publish and distribute video game software and content that can be played by consumers on a variety of platforms, including:

- Video game consoles such as the PLAYSTATION® 3, Microsoft Xbox 360 and Nintendo Wii ,
- Personal computers, including the Macintosh (we refer to personal computers and the Macintosh together as PCs),
- Handheld game players such as the PlayStation® Portable (PSP) and Nintendo DS , and
- Mobile devices, such as cellular phones and smart phones, including the Apple iPhone .

Our ability to publish games across multiple platforms has been, and will continue to be, a cornerstone of our product strategy. Historically, there have been multiple video game consoles and handheld game players available to consumers, and there has been vigorous competition among these platforms for consumer acceptance. In fiscal year 2010, the platforms for which we produced the most software products were:

Platform	Number of titles developed and published by EA in fiscal year 2010
Mobile	48
Xbox 360	22
PLAYSTATION 3	21
Wii	19
PC	16
Nintendo DS	16
PSP	10
PlayStation 2	6

Our products for videogame consoles, PCs and handhelds are delivered on physical media (disks and cartridges) that are sold at retailers (we call these packaged goods products). We also deliver game content and services online, directly to consumers, for the platforms listed above. Some online delivered content and services are add-ons or are related to our packaged goods products (*e.g.*, add-on content or matchmaking services); while other games, content and services that we offer, such as games for mobile devices, and Internet-only games, are available only through online delivery. We believe that online delivery of game content and services will become an increasingly important part of our business over time.

Our games span a diverse range of categories, including action-adventure, casual, sports, family, fantasy, racing, music, massively-multiplayer online role-playing, simulation and strategy. We have created, licensed and acquired a strong portfolio of intellectual property, which we market and sell to a variety of consumers. Our portfolio of wholly-owned properties includes established brands such as Need for Speed , The Sims , Spore , Dead Space , Mass Effect and Battlefield , and newly launched properties in fiscal year 2010 such as *EA SPORTS Active , Dragon Age : Origins,* and *Dante s Inferno* . Our portfolio of games based on licensed intellectual property includes sports-based titles such as Madden NFL Football, FIFA Soccer and Tiger Woods PGA Tour®, and titles based on popular brands such as Harry Potter and Hasbro. Through our EA Partners business, we also co-develop, co-publish and/or distribute video games that are developed and published by other companies, including the MTV Games/Harmonix series Rock Band and the Crytek series Crysis®.

Another cornerstone of our strategy is to publish products that can be iterated, or sequeled. For example, a new edition for most of our sports products, such as Madden NFL Football, is released each year. Other products, such as The Sims and Battlefield are sequeled on a less-frequent basis. We refer to these successful, iterated product families as franchises. We also make add-on content available for purchase online or through expansion packs sold at retail for many of our products.

We develop our games using both internal and external resources. For the fiscal years ended March 31, 2010, 2009 and 2008, research and development expenses were $1,229 million, $1,359 million and $1,145 million, respectively. We operate development studios (which develop products and perform other related functions) worldwide: BioWare (Canada and United States), Bright Light (United Kingdom), Criterion (United Kingdom), DICE (Sweden), EA Canada, EA Los Angeles (United States), EA Montreal (Canada), EA Romania, Maxis (United States), Playfish (United States, United Kingdom, China and Norway), EA Salt Lake City (United States), EA Seoul Studio (Korea), EA Singapore, EA Mythic (United States), Pogo (United States and China), The Sims Studio (United States), EA Tiburon (United States), and Visceral (United States). We have quality assurance functions located in the United States, Canada, the United Kingdom, Sweden, Germany, Romania, China, India, Korea, and Singapore and localization functions located in Germany, Spain and Japan. We also engage third parties to assist with the development of our games at their own development and production studios.

Our global sales network allows us to market, publish and distribute games in over 35 countries throughout the world. We generate a significant portion of our net revenue from direct sales of packaged goods products to retailers and in some of our smaller international territories, we work with third parties to distribute our packaged goods products. Many of our games, and other online content, are also available to consumers via proprietary networks, such as the Xbox LIVE® Marketplace on the Xbox 360 console and the PlayStation Network on the PLAYSTATION 3 and PSP consoles, or via the Internet, including our own online stores. We also market and distribute games and other content for mobile devices through mobile carriers and proprietary online stores that provide applications for specific devices (*i.e.*, mobile application storefronts such as the Apple App Store, which provides applications for the Apple iPhone and iPod Touch, or Google s Android Market for Android compatible phones).

Our North America net revenue, which was primarily generated in the United States, decreased by 16 percent to $2,025 million, or 55 percent of total net revenue in fiscal year 2010, as compared to $2,412 million, or 57 percent of total net revenue in fiscal year 2009 and as compared to $1,942 million, or 53 percent of total net revenue in fiscal year 2008. Internationally, we conduct business through our international headquarters in Switzerland and have wholly-owned subsidiaries throughout the world, including offices in Europe, Australia, Asia and Latin America. International net revenue (*i.e.*, net revenue derived from countries other than Canada and the United States) decreased by 10 percent to $1,629 million, or 45 percent of total net revenue in fiscal year 2010, as compared to $1,800 million, or 43 percent of total net revenue in fiscal year 2009 and as compared to $1,723 million, or 47 percent of total net revenue in fiscal year 2008.

The amounts of net revenue and long-lived assets attributable to each of our geographic regions for each of the last three fiscal years are set forth in Note 17 of the Notes to Consolidated Financial Statements, included in Item 8 of this report.

In fiscal years 2010 and 2009, no titles accounted for 10 percent or more of our total net revenue. In fiscal year 2008, sales of *Rock Band*, distributed for three platforms, represented approximately 10 percent of our total net revenue.

We were initially incorporated in California in 1982. In September 1991, we reincorporated under the laws of Delaware. Our principal executive offices are located at 209 Redwood Shores Parkway, Redwood City, California 94065 and our telephone number is (650) 628-1500.

Significant Business Developments in Fiscal 2010

Acquisition of Playfish Limited

On November 9, 2009, we acquired all of the outstanding shares of Playfish Limited (Playfish) for an aggregate purchase price of approximately $308 million in cash and equity. In addition, we may be required to pay additional variable cash consideration that is contingent upon the achievement of certain performance milestones through December 31, 2011. This additional consideration is limited to a maximum of $100 million. Playfish is a developer of free-to-play social games that can be played on social networking platforms and generates revenue through sales of digital content and Internet-based advertising.

Fiscal 2010 Restructuring Plan

In fiscal year 2010, we announced details of a restructuring plan to narrow our product portfolio to provide greater focus on titles with higher margin opportunities. Under this plan, we reduced our workforce by approximately 1,200 employees and have been (1) consolidating or closing various facilities, (2) eliminating certain titles, and (3) incurring IT and other costs to assist in reorganizing certain activities. The majority of these actions were completed by March 31, 2010.

Employee Stock Option Exchange Program

On October 21, 2009, we launched a voluntary Employee Stock Option Exchange Program (Exchange Program) to permit our eligible employees to exchange outstanding eligible options for a lesser number of restricted stock units, shares of restricted stock (in Canada only), or new options (in China only) to be granted under our 2000 Equity Incentive Plan (the Equity Plan). The Exchange Program offer period began on October 21, 2009 and ended on November 18, 2009.

Options eligible for the Exchange Program were those options granted prior to October 21, 2008, that had an exercise price per share greater than $28.18, which was the 52-week high trading price of our common stock measured as of the start date of the Exchange Program, as reported on the NASDAQ Global Select Market.

The Exchange Program resulted in options to purchase approximately 16,561,000 shares of our common stock being exchanged for restricted stock units to acquire approximately 4,996,000 shares, approximately 923,000 shares of restricted stock awards and new options to purchase approximately 18,000 shares.

Redwood Shores Headquarters Facilities Purchase

On July 13, 2009, we purchased our Redwood Shores headquarters facilities concurrent with the expiration and extinguishment of the lessor s financing agreements. These facilities were subject to lease obligations to non-affiliated parties, which expired in July 2009, and had previously been accounted for as operating leases. The total amount paid under the terms of the leases was $247 million, of which $233 million related to the purchase price of the facilities and $14 million was for the loss on our lease obligation. Subsequent to our purchase, we classified the facilities on our Consolidated Balance Sheet as property and equipment, net and depreciate the facilities acquired, excluding the land, on a straight-line basis over the estimated useful lives.

Our Operating Structure

We are organized into three Labels (EA Games, EA SPORTS and EA Play), our EA Interactive organization (EA Mobile, Pogo and Playfish) and our Global Publishing Organization. Each Label and EA Interactive operates globally with dedicated game development and marketing teams. Global Publishing operates in three regions North America, Europe and Asia and is responsible for a number of business functions such as: strategic planning, field marketing, sales, distribution, operations, product certification, quality assurance, motion capture, art outsourcing and localization within the local markets in which we operate.

EA Games Label

The EA Games Label is home to the largest number of our studios and development teams, which together create an expansive and diverse portfolio of games marketed under the EA brand in categories such as action-adventure, role playing, racing and first-person shooter games. The EA Games portfolio is comprised primarily of wholly-owned properties and includes several established franchises such as Need for Speed, Battlefield, Mass Effect and Dead Space. In addition, EA Games has recently launched new franchises including Dante s Inferno and Dragon Age, and has additional titles in development. In addition to traditional packaged goods games, EA Games also develops massively-multiplayer online role-playing games which are persistent state virtual worlds where thousands of other players can interact with one another (MMOs). Examples of MMOs include *Warhammer® Online: Age of Reckoning®* and *Star Wars : The Old Republic* , which is in development at our BioWare Austin Studio, in collaboration with LucasArts. EA Games titles are developed primarily at the following EA studios: BioWare (Edmonton, Canada, Austin, Texas, and Montreal, Canada), Criterion (Guildford, England), DICE (Stockholm, Sweden), EA Los Angeles, EA Montreal, Visceral (Redwood City, California), EA Mythic (Fairfax, Virginia), and EA Canada (Burnaby, Canada).

EA Games also includes the EA Partners group, which contracts with external game developers and third party companies, to provide these partners with a variety of services including development assistance, publishing, and distribution of their games.

EA SPORTS Label

The EA SPORTS Label brings together a collection of sports-based video games marketed under the EA SPORTS brand. EA SPORTS games range from simulated sports titles with realistic graphics based on real-world sports leagues, players, events and venues to more casual games with arcade-style gameplay and graphics. We seek to release new iterations of many of our EA SPORTS titles annually in connection with the commencement of a sports league s season or a major sporting event when appropriate. Our EA SPORTS franchises include FIFA Soccer, Madden NFL Football, Fight Night, NBA Live, NCAA Football, Tiger Woods PGA Tour, and NHL Hockey. EA SPORTS games are developed primarily at our EA Canada and our EA Tiburon studio located in Orlando, Florida.

EA Play Label

The EA Play Label is focused on creating compelling games for a mass audience of core and non-core gamers alike. EA Play games are intended to be easily accessible for people of all ages, and to inspire fun and creativity. Many EA Play games only require a minimal time commitment to learn, play and enjoy. EA Play Label products include (1) wholly-owned franchises such as The Sims, MySims, and Spore and (2) games published under licenses such as Harry Potter under license from Warner Bros., and video games based on Hasbro board games and toys. We have a long-term strategic agreement with Hasbro, which provides us with the exclusive worldwide rights to create digital games for all major platforms based on most of Hasbro s toy and game intellectual properties, including LITTLEST PET SHOP , MONOPOLY , SCRABBLE (United States and Canada only), TRIVIAL PURSUIT , NERF , and RISK (excluding Italy). A number of products under this agreement have been released in fiscal years 2009 and 2010 and we plan to release additional products based on Hasbro toy and game brands in fiscal year 2011. Our EA Play Label oversees internal studios and development teams located in California, United States, Utah, United States, Montreal, Canada and Guildford, England, and works with third party developers.

EA Interactive

EA Interactive reports into our Global Publishing Organization and is focused wholly on interactive games for play on the Internet and mobile devices. EA Interactive is comprised of EA Mobile, Pogo and Playfish.

EA Mobile. Through EA Mobile, we are a leading global publisher of games for mobile devices. Our customers purchase and download our games through a mobile carrier s branded e-commerce service and mobile application storefronts accessed directly from their mobile devices. EA Mobile develops games for mobile devices internally at studios located in Canada, Romania, Australia, India, and Korea. We also contract with third parties located in the United States, United Kingdom, Singapore, and China to develop games that will be produced by EA Mobile. Our focus is on producing high-quality, branded titles ranging from core to casual with variations of the same game for compatibility across the multitude of geographies, carriers, and mobile devices, including the Apple iPhone and iPad.

Pogo. Through our Pogo online service, we offer casual games such as card, puzzle and word games. We had approximately 1.6 million paying Club Pogo subscribers as of March 31, 2010. In addition to paid subscriptions, Pogo also generates revenue through Internet-based advertising and sales of digital content.

Playfish. Through Playfish we offer free-to-play social games including *Restaurant City*, *Pet Society*, *Country Story,* and *Gangster City,* that can be played on social networking platforms such as Facebook, MySpace, Google, Bebo, iPhone, and Android. As of March 31, 2010, we had approximately 46 million monthly active players across Playfish s 11 titles. Playfish generates revenue through sales of digital content and Internet-based advertising.

Global Publishing Organization

Global Publishing is responsible for the distribution, sales and marketing of our products (including strategic planning, operations, and manufacturing functions), and for centralized development and global online services in support of our Labels (such as product certification, quality assurance, motion capture, art outsourcing and localization within the local markets in which we operate).

Distribution, Sales and Marketing. Our global sales network allows us to market, publish and distribute games for all Labels throughout the world. Our North America publishing organization is headquartered in Redwood City, California. We have local offices in several states including Arkansas, Minnesota and Texas, among others. We also have a distribution center in Kentucky. Our international publishing operations are headquartered in Geneva, Switzerland, with offices throughout Europe, Australia, Asia and Latin America. We also use third party providers in Europe including Germany, Switzerland, and the United Kingdom, for our warehousing needs. Marketing activities primarily focus on television and online advertising, print advertising, retail merchandising, website development, event sponsorship, and trade shows.

Central Development and Global Online Services. Our Central Development Services group provides development services to our Labels, such as product localization, quality assurance and certification, motion capture, art outsourcing and media mastering. By grouping these services together within a single, centralized organization, we expect to continue to achieve efficiencies, while improving the overall quality of our games by providing more sophisticated and robust services than any of our Labels could sustain on its own. Key components of Central Development Services strategy are outsourcing to third parties and moving work offshore to lower-cost markets. Our Global Online Services group builds online development that enables our Labels to sell games and services directly to our customers.

Competition

We compete with other video game companies for the leisure time and discretionary spending of consumers, as well as with other providers of different forms of entertainment, such as motion pictures, television, social networking, online casual entertainment and music. Our competitors vary in size from very small companies with limited resources to very large, diversified corporations with global operations and greater financial resources than ours.

We also face competition from other video game companies and large media companies to obtain license agreements for the right to use some of the intellectual property included in our products. Some of these content licenses are controlled by the diversified media companies, which, in some cases, have decided to publish their own games based on popular entertainment properties that they control, rather than licensing the content to a video game company such as us.

Competition in Sales of Packaged Goods

The packaged goods video game business is characterized by the frequent launch of new games, which may be sequels of popular game franchises, or newly introduced game concepts. There is also rapid technological innovation in the packaged goods game business as competing companies continually improve their use of the powerful platforms on which games are designed to run, and extend the game experience through additional content and online services (such as matchmaking and multiplayer functionality). Competition is also based on product quality and features, timing of product releases, brand-name recognition, availability and quality of in-game content, access to distribution channels, effectiveness of marketing and price.

For sales of packaged goods, we compete directly with Sony, Microsoft and Nintendo, each of which develop and publish software for their respective console platforms. We also compete with numerous companies which, like us, develop and publish video games that operate on these consoles and on PCs and handheld game players. These competitors include Activision Blizzard, Atari, Capcom, Koei, Konami, LucasArts, Namco, Sega, Take-Two Interactive, THQ and Ubisoft. Diversified media companies such as Fox, Disney, Time Warner and Viacom are also expanding their software game publishing efforts.

We also see a change in retail sales patterns which decreases our ability to derive revenue from catalog sales (sales of games in the periods following the launch quarter). Currently, many console games experience sales cycles that are shorter than in the past. To mitigate this trend, we offer our consumers new direct-to-consumer services such as additional content to further enhance the gaming experience and extend the time that consumers play our games after their initial purchase.

Competition in Games for Mobile Devices

The mobile entertainment applications market segment, for which we develop and publish games for mobile devices, is characterized by frequent product introductions, rapidly emerging new mobile platforms, new technologies, and new mobile application storefronts. As the penetration of mobile devices that feature fully-functional browsers and additional gaming capabilities continues to deepen, the demand for applications continues to increase and as there are more mobile application storefronts through which developers can offer products, we expect new competitors to enter the market and existing competitors to allocate more resources to develop and market competing applications. As a result, we expect competition in the mobile entertainment market to intensify.

Current and potential competitors in the mobile entertainment applications market include major media companies, traditional video game publishing companies, mobile carriers, mobile software providers and other companies that specialize in mobile entertainment applications. We also compete with mobile content aggregators, who pool applications from multiple developers (and sometimes publishers) and offer them to carriers or through other sales channels. In addition, new and existing competitors are offering mobile entertainment applications on a free download, ad-supported basis. Currently, we consider our primary competitors in the mobile entertainment applications market to be Capcom Mobile, Gameloft, Glu Mobile, Namco, and PopCap.

Competition in Online Gaming Services

The online (*i.e.*, Internet-based) games market is characterized by frequent product introductions, new and evolving business models and new platforms. As the proportion of households with a broadband connection continues to grow, we expect new competitors to enter the market and existing competitors to allocate more resources toward developing online games services. As a result, we expect competition in the online game services market to intensify.

Our current and potential competitors in the online games market include major media companies, traditional video game publishing companies, and companies that specialize in online games including social networking game companies. In the massively multiplayer online game business, our competitors include Activision Blizzard, Atari, NC Soft, and Sony. Competing providers of other kinds of online games include AOL, Big Fish, MSN, Nexon, Popcap, Real, Yahoo!, and Zynga and other providers of games on social networking platforms such as Facebook.

Intellectual Property

Like other entertainment companies, our business is significantly based on the creation, acquisition, exploitation and protection of intellectual property. Some of this intellectual property is in the form of software code, patented technology, and other technology and trade secrets that we use to develop our games and to make them run properly. Other intellectual property is in the form of audio-visual elements that consumers can see, hear and interact with when they are playing our games we call this form of intellectual property content.

We develop products from wholly-owned intellectual properties we create within our own studios. We also acquire the rights to include proprietary intellectual property in our products through acquisitions. In addition, we obtain content and intellectual property through licenses and service agreements such as those with sports leagues and players associations, movie studios and performing talent, authors and literary publishers, music labels, music publishers and musicians. These agreements typically limit our use of the licensed rights in products for specific time periods. In addition, our products that play on game consoles, handhelds and mobile devices include technology that is owned by the console or mobile device manufacturer and licensed non-exclusively to us for use. We also license technology from providers other than console and mobile device manufacturers. While we may have renewal rights for some licenses, our business and the justification for the development of many of our products is dependent on our ability to continue to obtain the intellectual property rights from the owners of these rights on reasonable terms and at reasonable rates.

We actively engage in enforcement and other activities to protect our intellectual property. We typically own the copyright to the software code, as well as the brand or title name trademark under which our products are marketed. We register copyrights and trademarks in the United States and other countries as appropriate.

As with other forms of entertainment, our products are susceptible to unauthorized copying and piracy. We typically distribute our PC products using copy protection technology, digital rights management technology or other technological protection measures to prevent piracy and the use of unauthorized copies of our products. In addition, console manufacturers typically incorporate technological protections and other security measures in their consoles in an effort to prevent the use of unlicensed product. We are actively engaged in enforcement and other activities to protect against unauthorized copying and piracy, including monitoring online channels for distribution of pirated copies, and participating in various industry-wide enforcement initiatives, education programs and legislative activity around the world.

Significant Relationships

Console Manufacturers

Sony. Under the terms of agreements we have entered into with Sony Computer Entertainment Inc. and its affiliates, we are authorized to develop and distribute disk-based software products and online content compatible with the PlayStation 2, PLAYSTATION 3 and PSP. Pursuant to these agreements, we engage Sony to supply PlayStation 2, PLAYSTATION 3 and PSP disks for our products.

Microsoft. Under the terms of agreements we have entered into with Microsoft Corporation and its affiliates, we are authorized to develop and distribute DVD-based software products and online content compatible with the Xbox 360.

Nintendo. Under the terms of agreements we have entered into with Nintendo Co., Ltd. and its affiliates, we are authorized to develop and distribute proprietary optical format disk products and cartridges compatible with the Wii and the Nintendo DS. Pursuant to these agreements, we engage Nintendo to supply Wii proprietary optical format disk products and Nintendo DS cartridges for our products.

Under the agreements with each of Sony, Microsoft and Nintendo, we are provided with the non-exclusive right to use, for a fixed term and in a designated territory, technology that is owned by the console manufacturer in order to publish our games on such platform. Our transactions are made pursuant to individual purchase orders, which are accepted on a case-by case basis by Sony, Microsoft or Nintendo, as the case may be, and there are no minimum purchase requirements under the agreements. Many key commercial terms of our relationships with Sony, Microsoft and Nintendo such as manufacturing terms, delivery times and approval conditions are determined unilaterally, and, are subject to change, by the console manufacturers. We pay the console manufacturers a per unit royalty for each unit manufactured or for revenue from downloaded content.

As each platform license expires, if we intend to continue publishing games on such platform, we must enter into a new agreement or an amendment with the licensor to extend the term of the agreement. Certain agreements, such as the licenses with Sony for the PLAYSTATION 3 and with Microsoft for the Xbox 360, automatically renew for a specified period unless either party gives notice by the applicable date that it intends to terminate the agreement.

The platform license agreements also require us to indemnify the manufacturers with respect to all loss, liability and expense resulting from any claim against the manufacturer involving the development, marketing, sale, or use of our games, including any claims for copyright or trademark infringement brought against the manufacturer. Each platform license may be terminated by the manufacturer if a breach or default by us is not cured after we receive written notice from the manufacturer, or if we become insolvent.

Retailers

The console, handheld and PC games that we publish are made available to consumers as packaged goods (usually in Blu-ray Disc, CD, DVD, cartridge or Universal Media Disc format) that are typically sold at retailers (including online retailers, such as Amazon). In North America and Europe, our largest markets, we sell these packaged goods products primarily to retailers, including mass market retailers (such as Wal-Mart), electronics specialty stores (such as Best Buy) or game software specialty stores (such as GameStop). Many of our products and related content (such as booster packs, expansion packs and smaller pieces of game content) can also be purchased over the Internet through digital download or through mobile application storefronts accessed directly from videogame consoles or mobile devices.

We generated approximately 75 percent of our North America net revenue from direct sales to retailers in fiscal year 2010, with the remaining net revenue being generated through a limited number of specialized and regional distributors in markets where we believe direct sales would not be economical. We had direct sales to GameStop Corp. which represented approximately 16 percent, 14 percent and 13 percent of total net revenue in fiscal years 2010, 2009 and 2008, respectively. We also had direct sales to Wal-Mart Stores, Inc. which represented approximately 12 percent, 14 percent and 12 percent of total net revenue in fiscal years 2010, 2009 and 2008, respectively. We sell our products to GameStop and Wal-Mart pursuant to numerous and frequent individual purchase orders, which contain delivery and pricing terms. There is no commitment by either GameStop or Wal-Mart to purchase or for us to sell to either GameStop or Wal-Mart, any minimum level of product.

Mobile Carriers

We have agreements to distribute our mobile applications through more than 320 carriers in over 55 countries. Our customers download our applications to their mobile devices and their mobile carrier invoices them either a one-time or monthly subscription fee. Our carrier distribution agreements establish the fees to be retained by the carrier for distributing our applications. These arrangements are typically terminable on short notice. The agreements generally do not obligate the carriers to market or distribute any of our applications.

Content Licensors

Many of our products are based on or incorporate content and trademarks owned by others. For example, our products include rights licensed from third parties, including major movie studios, publishers, artists, authors, celebrities, traditional game and toy companies, athletes and the major sports leagues and players associations.

EA Partners

Through our EA Partners group, we team with external game developers and third party companies, to provide these partners with a variety of services including development assistance, publishing, and distribution. For example, through agreements with Crytek and Harmonix, a subsidiary of Viacom, we plan to release *Crysis 2,* and have released *The Beatles: Rock Band,* respectively. Additionally, we have a development agreement with Epic Games for our upcoming release of *Bulletstorm*.

Inventory, Working Capital, Backlog, Manufacturing and Suppliers

We manage inventory by communicating with our customers prior to the release of our products, and then using our industry experience to forecast demand on a product-by-product and territory-by-territory basis. Historically, we have experienced high turnover of our products, and the lead times on re-orders of our products are generally two to three weeks. Further, as discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations, we have practices in place with our customers (such as stock balancing and price protection) that reduce product returns.

We typically ship orders immediately upon receipt. To the extent that any backlog may or may not exist at the end of a reporting period, it would be an unreliable indicator of future results of any period.

In many instances, we are able to acquire materials on a volume-discount basis. We have multiple potential sources of supply for most materials, except for the disk or cartridge component of our PLAYSTATION 3, PlayStation 2, PSP, Wii and Nintendo DS products.

Seasonality

Our business is highly seasonal. We have historically experienced our highest sales volume in the holiday season quarter ending in December and a seasonal low in sales volume in the quarter ending in June. While our sales generally follow this seasonal trend, there can be no assurance that this trend will continue. In addition, we defer the recognition of a significant amount of net revenue related to our online-enabled packaged goods and digital content over an extended period of time (generally six months). As a result, the quarter in which we generate the highest sales volume may be different than the quarter in which we recognize the highest amount of net revenue. Our results can also vary based on a number of factors, including title release dates, consumer demand for our products, shipment schedules and our revenue recognition policies.

Employees

As of March 31, 2010, we had approximately 7,800 regular, full-time employees, over 4,600 of whom were outside the United States. We believe that our ability to attract and retain qualified employees is a critical factor in the successful development of our products and that our future success will depend, in large measure, on our ability to continue to attract and retain qualified employees. Approximately 3 percent of our employees, all of whom work for DICE, our Swedish development studio, are represented by a union.

Executive Officers

The following table sets forth information regarding our executive officers as of May 28, 2010:

Name	Age	Position
John S. Riccitiello	50	Chief Executive Officer
John Schappert	39	Chief Operating Officer
Eric F. Brown	44	Executive Vice President, Chief Financial Officer
Frank D. Gibeau	41	President, EA Games Label
Peter R. Moore	55	President, EA SPORTS Label
Rodney Humble	44	Executive Vice President, EA Play Label
Nancy Smith	57	Executive Vice President, Global Publishing
Joel Linzner	58	Executive Vice President, Business and Legal Affairs
Gabrielle Toledano	43	Executive Vice President, Human Resources and Facilities
Kenneth A. Barker	43	Senior Vice President, Chief Accounting Officer
Stephen G. Bené	46	Senior Vice President, General Counsel and Corporate Secretary

Mr. Riccitiello has served as Chief Executive Officer and a Director of Electronic Arts since April 2007. Prior to re-joining Electronic Arts, he was a co-founder and Managing Partner at Elevation Partners, a private equity fund. From October 1997 to April 2004, he served as President and Chief Operating Officer of Electronic Arts. Prior to joining Electronic Arts, Mr. Riccitiello served as President and Chief Executive Officer of the worldwide bakery division at Sara Lee Corporation. Before joining Sara Lee, he served as President and Chief Executive Officer of Wilson Sporting Goods Co. and has also held executive management positions at Haagen-Dazs, PepsiCo, Inc. and The Clorox Company. Mr. Riccitiello holds a B.S. degree from the University of California, Berkeley. Mr. Riccitiello served as a director of Hyperion Solutions Corporation from July 2002 to April 2007. He serves on the Board of Directors of the UC Berkeley Haas School of Business and on the Board of Councilors of the USC School of Cinematic Arts.

Mr. Schappert has served as Chief Operating Officer of Electronic Arts since July 2009. Prior to re-joining Electronic Arts, he served as Corporate Vice President of Microsoft Interactive Entertainment Business, responsible for their Xbox LIVE and Microsoft Game Studios businesses. From November 2006 to July 2007, Mr. Schappert served as Senior Vice President, Chief Operating Officer, Worldwide Studios of Electronic Arts. Prior to this, Mr. Schappert served as Senior Vice President, Group General Manager, Worldwide Studios of EA from January 2003 to October 2006, Vice President, General Manager of EA Canada from July 2002 to January 2003, and Vice President, General Manager of EA Tiburon from April 1998 to July 2002. Mr. Schappert founded Tiburon Entertainment in 1994, which was acquired by Electronic Arts in 1998.

Mr. Brown has served as Executive Vice President, Chief Financial Officer since April 2008. Prior to joining Electronic Arts, he served as Chief Operating Officer and Chief Financial Officer of McAfee, Inc., a security technology company from March 2006 until March 2008. From January 2005 until March 2006, Mr. Brown was McAfee s Executive Vice President and Chief Financial Officer. Mr. Brown served as President and Chief Financial Officer of MicroStrategy Incorporated, a business intelligence software provider, from 2000 until 2004. Mr. Brown received an M.B.A. from the Sloan School of Management of the Massachusetts Institute of Technology and a B.S. in Chemistry from the Massachusetts Institute of Technology.

Mr. Gibeau was named President, EA Games Label in June 2007. Prior to that time, he had served as Executive Vice President, General Manager, North America Publishing beginning in September 2005. From 2002 until September 2005, he was Senior Vice President of North American Marketing. Mr. Gibeau has held various publishing positions since joining the company in 1991. Mr. Gibeau holds a B.S. degree from the University of Southern California and an M.B.A. from Santa Clara University.

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Mr. Moore was named President, EA SPORTS, in September 2007. From January 2003 until he joined Electronic Arts, Mr. Moore was with Microsoft where he served as head of Xbox marketing and was later named as Corporate Vice President, Interactive Entertainment Business, Entertainment and Devices Division, a position in which he led both the Xbox and Games for Windows businesses. Prior to joining Microsoft, Mr. Moore was President and Chief Operating Officer of SEGA of America, where he was responsible for overseeing SEGA s video game business in North America. Before joining SEGA, Mr. Moore was Senior Vice President of Marketing at Reebok International Ltd. Mr. Moore holds a bachelor s degree from Keele University, United Kingdom, and a Master s degree from California State University, Long Beach.

Mr. Humble was named Executive Vice President, EA Play Label in November 2008. Mr. Humble joined Electronic Arts in October 2004, where he served as Executive Producer of The Sims studio before becoming Vice President in February 2006. Mr. Humble was promoted to Senior Vice President of The Sims studio in August 2007 and Executive Vice President of The Sims studio in September 2008. Prior to joining Electronic Arts, Mr. Humble was the Vice President of Product Development at Sony Online Entertainment from 2000 to 2004. From 1997 to 2000, he served as Chief Executive Officer of Harmless Games, an independent games company that he co-owned. From 1995 to 1997, Mr. Humble served as Executive Producer at Virgin Interactive and from 1990 to 1995 he served as Executive Producer at Gametek.

Ms. Smith was named Executive Vice President, Global Publishing in February 2010. From November 2008 until February 2010, Ms. Smith served Electronic Arts in a variety of capacities. From September 2005 until November 2008, she led The Sims Label, first as Executive Vice President and General Manager of The Sims Franchise, and then as President of The Sims Label. From March 1998 until September 2005, she served as Executive Vice President and General Manager, North American Publishing. From October 1996 to March 1998, Ms. Smith served as Executive Vice President, North American Sales. She held the position of Senior Vice President, North American Sales and Distribution from July 1993 to October 1996 and Vice President Sales from 1988 to 1993. From 1984 to 1988, Ms. Smith served as Western Regional Sales Manager and National Sales Manager. Ms. Smith holds a B.S. degree in management and organizational behavior from the University of San Francisco.

Mr. Linzner has served as Executive Vice President, Business and Legal Affairs since March 2005. From April 2004 to March 2005, he served as Senior Vice President, Business and Legal Affairs. From October 2002 to April 2004, Mr. Linzner held the position of Senior Vice President of Worldwide Business Affairs and from July 1999 to October 2002, he held the position of Vice President of Worldwide Business Affairs. Prior to joining Electronic Arts in July 1999, Mr. Linzner served as outside litigation counsel to Electronic Arts and several other companies in the video game industry. Mr. Linzner earned his J.D. from Boalt Hall at the University of California, Berkeley, after graduating from Brandeis University. He is a member of the Bar of the State of California and is admitted to practice in the United States Supreme Court, the Ninth Circuit Court of Appeals and several United States District Courts.

Ms. Toledano has served as Executive Vice President, Human Resources and Facilities since April 2007. From February 2006 to April 2007, Ms. Toledano held the position of Senior Vice President, Human Resources and Facilities. Prior to joining Electronic Arts, Ms. Toledano worked at Siebel Systems, Inc. from July 2002 to February 2006 where she held a number of positions, including Senior Vice President of Human Resources. From September 2000 to June 2002, she served as Senior Director of Human Resources for Microsoft Corporation, and from September 1998 until September 2000, she served as Director of Human Resources and Recruiting for Microsoft. Ms. Toledano earned both her undergraduate degree in Humanities and her graduate degree in Education from Stanford University. Ms Toledano also serves on the Board of Directors of the Society of HR Management.

Mr. Barker has served as Senior Vice President, Chief Accounting Officer since April 2006. From June 2003 to April 2006, Mr. Barker held the position of Vice President, Chief Accounting Officer. Prior to joining Electronic Arts, Mr. Barker was employed at Sun Microsystems, Inc., as Vice President and Corporate Controller from October 2002 to June 2003 and Assistant Corporate Controller from April 2000 to September 2002. Prior to that, he was an audit partner at Deloitte. Mr. Barker graduated from the University of Notre Dame with a B.A. degree in Accounting.

Mr. Bené has served as Senior Vice President, General Counsel and Corporate Secretary since October 2004. From April 2004 to October 2004, Mr. Bené held the position of Vice President, Acting General Counsel and Corporate Secretary, and from June 2003 to April 2004, he held the position of Vice President and Associate General Counsel. Prior to June 2003, Mr. Bené had served as internal legal counsel since joining EA in March 1995. Mr. Bené earned his J.D. from Stanford Law School, and received his B.S. in Mechanical Engineering from Rice University. Mr. Bené is a member of the Bar of the State of California.

Investor Information

Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and any amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act, as amended, are available free of charge on the Investor Relations section of our website at http://investor.ea.com as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. Except as expressly set forth in this Form 10-K annual report, the contents of our website are not incorporated into, or otherwise to be regarded as part of this report.

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Item 1A: ***Risk Factors***

Our business is subject to many risks and uncertainties, which may affect our future financial performance. If any of the events or circumstances described below occurs, our business and financial performance could be harmed, our actual results could differ materially from our expectations and the market value of our stock could decline. The risks and uncertainties discussed below are not the only ones we face. There may be additional risks and uncertainties not currently known to us or that we currently do not believe are material that may harm our business and financial performance.

Our business is highly dependent on the success and availability of video game hardware systems manufactured by third parties, as well as our ability to develop commercially successful products for these systems.

We derive most of our revenue from the sale of products for play on video game hardware systems (which we also refer to as platforms) manufactured by third parties, such as Sony s PLAYSTATION 3, Microsoft s Xbox 360 and Nintendo s Wii. The success of our business is driven in large part by the commercial success and adequate supply of these video game hardware systems, our ability to accurately predict which systems will be successful in the marketplace, and our ability to develop commercially successful products for these systems. We must make product development decisions and commit significant resources well in advance of anticipated product ship dates. A platform for which we are developing products may not succeed or may have a shorter life cycle than anticipated. If consumer demand for the systems for which we are developing products is lower than our expectations, our revenue will suffer, we may be unable to fully recover the investments we have made in developing our products, and our financial performance will be harmed. Alternatively, a system for which we have not devoted significant resources could be more successful than we had initially anticipated, causing us to miss out on meaningful revenue opportunities.

If we do not consistently meet our product development schedules, our operating results will be adversely affected.

Our business is highly seasonal, with the highest levels of consumer demand and a significant percentage of our sales occurring in the December quarter. In addition, we seek to release many of our products in conjunction with specific events, such as the release of a related movie or the beginning of a sports season or major sporting event. If we miss these key selling periods for any reason, including product delays or delayed introduction of a new platform for which we have developed products, our sales will suffer disproportionately. Likewise, if a key event to which our product release schedule is tied were to be delayed or cancelled, our sales would also suffer disproportionately. Our ability to meet product development schedules is affected by a number of factors, including the creative processes involved, the coordination of large and sometimes geographically dispersed development teams required by the increasing complexity of our products and the platforms for which they are developed, and the need to fine-tune our products prior to their release. We have experienced development delays for our products in the past, which caused us to push back release dates. In the future, any failure to meet anticipated production or release schedules would likely result in a delay of revenue and/or possibly a significant shortfall in our revenue, increase our development expense, harm our profitability, and cause our operating results to be materially different than anticipated.

Our business is intensely competitive and hit driven. If we do not deliver hit products and services or if consumers prefer our competitors products or services over our own, our operating results could suffer.

Competition in our industry is intense and we expect new competitors to continue to emerge in the United States and abroad. While many new products and services are regularly introduced, only a relatively small number of hit titles accounts for a significant portion of total revenue in our industry. We find that driving hit titles often requires large marketing budgets and media spend. We may not recover the investments that we make in marketing and advertising on certain products and that could harm our profitability. Hit products or services offered by our competitors may take a larger share of consumer spending than we anticipate, which could cause revenue generated from our products and services to fall below expectations. If our competitors develop and market more successful products or services, offer competitive products or services at lower price points or based on payment models perceived as offering a better value proposition (such as pay-for-play or subscription-based models), or if we do not continue to develop consistently high-quality and well-received products and services, our revenue, margins, and profitability will decline.

Our adoption of new business models could fail to produce our desired financial returns

We are actively seeking to monetize the game properties that we publish through a variety of new platforms and business models, including online distribution, micro-transactions, and subscription services. Forecasting our revenues and profitability for these new business models is inherently uncertain and volatile. Our actual revenues and profits for these businesses may be significantly greater or less than our forecasts. Additionally, these new business models could fail for one or more of our titles, resulting in the loss of our investment in the development and infrastructure needed to support these new business models, and the opportunity cost of diverting management and financial resources away from more successful businesses.

If our marketing and advertising efforts fail to resonate with our customers, our business and operating results could be adversely affected.

Our products are marketed worldwide through a diverse spectrum of advertising and promotional programs such as television and online advertising, print advertising, retail merchandising, website development and event sponsorship. Our ability to sell our products and services is dependent in part upon the success of these programs. If the marketing for our products and services fail to resonate with our customers, particularly during the critical holiday season or during other key selling periods, or if advertising rates or other media placement costs increase, these factors could have a material adverse impact on our business and operating results.

Uncertainty and adverse changes in the economy could have a material adverse impact on our business and operating results.

As a result of the national and global economic downturn, overall consumer spending has declined and retailers globally have taken a more conservative stance in ordering game inventory. The decrease in discretionary consumer spending contributed to the decline in the demand for our products during the 2009 holiday selling season. Continued economic distress, which may result in a further decrease in demand for our products, particularly during key product launch windows, could have a material adverse impact on our operating results and financial condition. Uncertainty and adverse changes in the economy could also increase the risk of material losses on our investments, increase costs associated with developing and publishing our products, increase the cost and decrease the availability of sources of financing, and increase our exposure to material losses from bad debts, any of which could have a material adverse impact on our financial condition and operating results. If we experience further deterioration in our market capitalization or our financial performance, we could be required to recognize significant impairment charges in future periods.

Our business is subject to currency fluctuations.

International sales are a fundamental part of our business. For the fiscal year ended March 31, 2010, international net revenue comprised 45 percent of our total net revenue. We expect international sales to continue to account for a significant portion of our total net revenue. Such sales may be subject to unexpected regulatory requirements, tariffs and other barriers. Additionally, foreign sales are primarily made in local currencies, which may fluctuate against the U.S. dollar. In addition, our foreign investments and our cash and cash equivalents denominated in foreign currencies are subject to currency fluctuations. We use foreign currency forward contracts to mitigate some foreign currency risk associated with foreign currency denominated monetary assets and liabilities (primarily certain intercompany receivables and payables) to a limited extent and foreign currency option contracts to hedge foreign currency forecasted transactions (primarily related to a portion of the revenue and expenses denominated in foreign currency generated by our operational subsidiaries). However, these activities are limited in the protection they provide us from foreign currency fluctuations and can themselves result in losses. The disruption in the global financial markets has also impacted many of the financial institutions with which we do business. A sustained decline in the financial stability of financial institutions as a result of the disruption in the financial markets could negatively impact our treasury operations, including our ability to

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secure credit-worthy counterparties for our foreign currency hedging programs. Accordingly, our results of operations, including our reported net revenue, operating expenses and net income, and financial condition can be adversely affected by unfavorable foreign currency fluctuations, especially the Euro, British pound sterling and Canadian dollar.

Volatility in the capital markets may adversely impact the value of our investments and could cause us to recognize significant impairment charges in our operating results.

Our portfolio of short-term investments and marketable equity securities is subject to volatility in the capital markets and to national and international economic conditions. In particular, our international investments can be subject to fluctuations in foreign currency and our short-term investments are susceptible to changes in short-term interest rates. These investments are also impacted by declines in value attributable to the credit-worthiness of the issuer. From time to time, we may liquidate some or all of our short-term investments or marketable equity securities to fund operational needs or other activities, such as capital expenditures, strategic investments or business acquisitions, or for other purposes. If we were to liquidate these short-term investments at a time when they were worth less than what we had originally purchased them for, or if the obligor were unable to pay the full amount at maturity, we could incur a significant loss. Similarly, we hold marketable equity securities, which have been and may continue to be adversely impacted by price and trading volume volatility in the public stock markets. We could be required to recognize impairment charges on the securities held by us and/or we may realize losses on the sale of these securities, all of which could have an adverse effect on our financial condition and results of operations. For the fiscal year ended March 31, 2010, we recognized impairment charges of $26 million on our investment in The9.

The majority of our sales are made to a relatively small number of key customers. If these customers reduce their purchases of our products or become unable to pay for them, our business could be harmed.

During the fiscal year ended March 31, 2010, approximately 75 percent of our North American sales were made to our top ten customers. In Europe, our top ten customers accounted for approximately 48 percent of our sales in that territory during the fiscal year ended March 31, 2010. Worldwide, we had direct sales to two customers, GameStop Corp. and Wal-Mart Stores Inc., which represented approximately 16 percent and 12 percent, respectively, of total net revenue for the fiscal year ended March 31, 2010. As a result of the economic downturn, retailers globally continue to take a more conservative stance in ordering game inventory. Though our products are available to consumers through a variety of retailers, the concentration of our sales in one, or a few, large customers could lead to a short-term disruption in our sales if one or more of these customers significantly reduced their purchases or ceased to carry our products, and could make us more vulnerable to collection risk if one or more of these large customers became unable to pay for our products or declared bankruptcy. Additionally, our receivables from these large customers increase significantly in the December quarter as they make purchases in anticipation of the holiday selling season. Also, having such a large portion of our total net revenue concentrated in a few customers could reduce our negotiating leverage with these customers. If one or more of our key customers experience deterioration in their business, or become unable to obtain sufficient financing to maintain their operations, our business could be harmed.

Sales of used video game products could lower our sales of new video games.

Certain of our retail customers sell used video games. Used video game sales have been growing in North America, and are emerging in Europe. Used video games are generally priced lower than new video games and the margins on used games sales are generally greater for retailers than the margins on new game sales. We do not receive revenue from used video game sales. Sales of used video games may negatively impact our sales and profitability, and may continue to do so, to a greater or lesser extent, in the future.

Our industry is cyclical, driven by the periodic introduction of new video game hardware systems. As we continue to move through the current cycle, our industry growth may slow down and as a result, our operating results may be difficult to predict.

Video game hardware systems have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. The current cycle began with Microsoft s launch of the Xbox 360 in 2005, and continued in 2006 when Sony and Nintendo launched their next-generation systems, the PLAYSTATION 3 and the Wii, respectively. Sales of software designed for these hardware systems represent the majority of our revenue, so our growth and success is highly correlated to sales of video game hardware systems. While there are indications that this current cycle may be extended longer than prior cycles in part, due to the growth of online services and content, the greater graphic and processing power of the current generation hardware, and the introduction of new peripherals growth in the installed base of the current generation of video game systems is likely to slow down in the coming years. This slow-down in sales of video game players may cause a corresponding slow-down in the growth of sales of video game software, which could significantly affect our operating results.

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$

(338,829

)

(763,062

)

$

(1,095,813

)

$

21,917,493

Net unrealized loss on derivative instruments, net of tax

(129,828

)

(129,828

)

Stock bonuses	372,650

55,479

79,286

451,936

Purchase of intangibles	
	1,830,100

300,000

429,900

2,260,000

Net income	6,033,085

6,033,085

Balance as of September 30, 2010

7,192,500

$

23,975

$

9,645,096

$

21,918,899

$

(468,657

)

(407,583

)

$

(586,627

)

$

30,532,686

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(UNAUDITED)

	2010	2009
Cash flows from operating activities		
Net income	$ 6,033,085	$ 3,737,487
Adjustments to reconcile net income to net cash from/(used in) operating activities:		
Depreciation and amortization	2,681,078	2,024,559
Stock distribution to employees	451,936	59,980
Deferred income taxes		144,513
Reduction in provision for doubtful accounts		(390,000)
Gain on sale of property and equipment	(256,041)	(53,108)
Change in assets and liabilities		
Receivables	(27,658,043)	(11,755,542)
Net investment in sales-type leases	20,472	40,172
Inventories	(4,446,027)	(7,889,385)
Other assets	(722,462)	(430,016)
Accounts payable	10,023,047	9,290,956
Accrued bonuses/commissions	289,600	1,284,300
Income taxes payable	2,075,715	1,881,766
Other current liabilities	113,157	(860,632)
Net cash used in operating activities	(11,394,483)	(2,914,950)
Cash flows from investing activities		
Proceeds from sale of property and equipment	351,109	86,022
Purchases of property and equipment	(1,870,801)	(1,677,756)
Deposits on equipment	(605,711)	(341,515)
Payments for shredder system		(6,436,584)
Acquisition from Venture Metals		(10,607,944)
Payments from related party	30,306	28,687
Net cash used in investing activities	(2,095,097)	(18,949,090)
Cash flows from financing activities		
(Payments on) proceeds from note payable to BB&T	(5,000,000)	5,000,000
Proceeds from Fifth Third Bank	48,800,000	
(Payments on) proceeds from other BB&T debt	(28,499,373)	19,577,657
Payments on other long-term debt	(434,606)	(2,794,070)
Payments on capital lease obligation	(20,798)	(61,088)
Net cash from financing activities	14,845,223	21,722,499
Net increase/(decrease) in cash	1,355,643	(141,541)
Cash at beginning of period	713,062	1,103,842
Cash at end of period	$ 2,068,705	$ 962,301
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 1,021,949	$ 702,555

Cash paid for taxes	$	1,946,341		642,717
Supplemental disclosure of noncash investing and financing activities:				
Common stock issued to acquire real estate	$		$	4,000,000
Common stock issued to acquire intangibles	$	2,260,000	$	

See accompanying notes to consolidated financial statements.

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INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U. S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U. S. generally accepted accounting principles for complete consolidated financial statements. The information furnished includes all adjustments, which are, in the opinion of management, necessary to present fairly our financial position as of September 30, 2010 and the results of our operations and changes in our cash flow for the periods ended September 30, 2010 and 2009. Results of operations for the period ended September 30, 2010 are not necessarily indicative of the results that may be expected for the entire year. Additional information, including the audited December 31, 2009 consolidated financial statements and the Summary of Significant Accounting Policies, is included in our Annual Report on Form 10-K for the year ended December 31, 2009 on file with the Securities and Exchange Commission.

Fair Value

We carry certain of our financial assets and liabilities at fair value on a recurring basis. These financial assets and liabilities are composed of trading account assets and various types of derivative instruments. In addition, we measure certain nonfinancial assets, such as goodwill and other long-lived assets, at fair value on a non-recurring basis to evaluate those assets for potential impairment. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

In accordance with the accounting standard, we categorize our financial assets and liabilities into the following fair value hierarchy:

Level 1 Financial assets and liabilities with values based on unadjusted quoted prices for identical assets or liabilities in an active market. Examples of level 1 financial instruments include active exchange-traded equity securities and certain U.S. government securities.

Level 2 Financial assets and liabilities with values based on quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability. Examples of level 2 financial instruments include commercial paper purchased from the State Street-administered asset-backed commercial paper conduits, various types of interest-rate derivative instruments, and various types of fixed-income investment securities. Pricing models are utilized to estimate fair value for certain financial assets and liabilities categorized in level 2.

Level 3 Financial assets and liabilities with values based on prices or valuation techniques that require inputs that are both unobservable in the market and significant to the overall fair value measurement. These inputs reflect management s judgment about the assumptions that a market participant would use in pricing the asset or liability, and are based on the best available information, some of which is internally developed. Examples of level 3 financial instruments include certain corporate debt with little or no market activity and a resulting lack of price transparency.

When determining the fair value measurements for financial assets and liabilities carried at fair value on a recurring basis, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability. When possible, we look to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, we look to market observable data for similar assets and liabilities. Nevertheless, certain assets and liabilities are not actively traded in observable markets, and we use alternative valuation techniques to derive fair value measurements.

We use the fair value methodology outlined in the related accounting standard to value the assets and liabilities for cash, debt and derivatives. All of our cash is defined as Level 1 and all our debt and derivative contracts are defined as Level 2. In accordance with this guidance, the following table represents our fair value hierarchy for Level 1 and Level 2 financial instruments at September 30, 2010:

	Level 1	Level 2	Total
Assets			
Cash and cash equivalents	$ 2,068,705		$ 2,068,705
Liabilities			
Long-term debt		($49,060,391)	($49,060,391)
Derivative contract		($ 781,094)	($ 781,094)

We have had no transfers in or out of Levels 1 or 2 fair value measurements. On July 1, 2010, ISA purchased the Venture Metals, LLC customer list, trade name, and a non-compete agreement, Level 3 assets (See Note 2 Intangibles). We have had no other activity in Level 3 fair value measurements for the quarter ending September 30, 2010. For Level 3 assets, goodwill and other indefinite life intangibles are subject to impairment analysis each year end under Phase I of the ASC guidance. We use an annual capitalized earnings computation to evaluate Level 3 assets for impairment.

Subsequent Events

We have evaluated the period from September 30, 2010 through the date the financial statements herein were issued, for subsequent events requiring recognition or disclosure in the financial statements and we identified the following event:

New Promissory Note:

On October 19, 2010, we entered into a Promissory Note (the Note) with Fifth Third Bank in the amount of $1,320,240 for the purpose of purchasing equipment. The interest rate is equal to five and 20/100 percent (5.20%) per annum; provided, however, that (A) such interest rate is based on an interest rate swap rate for a term approximating the weighted average life of the Note as quoted in the Bloomberg SWAP Rate report as of the date of the Note and (B) such interest rate may be adjusted by Fifth Third Bank based upon a corresponding increase in the interest rate swap rate quoted in such Release as in effect on the date of the advance. Principal and interest is payable monthly in consecutive equal installments of $30,511 with the first such payment commencing November 15, 2010, and the final unpaid principal amount due, together with all accrued and unpaid interest, charges, fees, or other advances, if any, to be paid on October 15, 2014. As security for the Note, we provided Fifth Third Bank a first priority security interest in the equipment purchased with the proceeds.

NOTE 2 INTANGIBLES

Purchased intangible assets are initially recorded at cost and finite life intangible assets are amortized over their useful economic lives on a straight line basis. Intangible assets having indefinite lives and intangible assets that are not yet ready for use are not amortized and are reviewed annually for impairment in accordance with Note 1 Summary of Significant Accounting Policies Fair Value.

Intangible assets are considered to have indefinite lives when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate cash flows for the Company. The factors considered in making this determination include the existence of contractual rights for unlimited terms and the life cycles of the products and processes that depend on the asset. We are in the process of finalizing the allocation process related to the intangibles acquired with the independent third party appraiser. This evaluation will be completed in the fourth quarter.

NOTE 3 ESTIMATES

In preparing the condensed consolidated financial statements in accordance with U. S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, management must make estimates and assumptions. These estimates and assumptions affect the amounts reported for assets, liabilities, revenues and expenses, as well as affecting the disclosures provided. Future results could differ from the current estimates.

NOTE 4 LONG TERM DEBT AND NOTES PAYABLE TO BANK

On July 30, 2010, we entered into a Credit Agreement (the Credit Agreement) with Fifth Third Bank pursuant to which Fifth Third Bank agreed to provide us a revolving credit facility in the amount of $40,000,000 for the purpose of replacing the existing $20,000,000 senior revolving credit facility with Branch Banking and Trust Company (BB&T) and for payment of the $5,000,000 note payable to BB&T (collectively, the Prior Obligations). Proceeds of the new revolving credit facility in the amount of $33,355,003 were used to repay the outstanding principal balance of the Prior Obligations. We used additional proceeds of the revolving credit facility to pay closing costs and for funding temporary fluctuations in accounts receivable of most of our customers and inventory. In addition, we entered into a term loan agreement with Fifth Third Bank in the amount of $8,800,000 for the purpose of replacing the $6,000,000 note payable secured by our shredder system, the $3,000,000 note payable secured by our rental fleet equipment, and the $609,900 note payable secured by our crane.

With respect to the revolving credit facility, the interest rate is one month LIBOR plus two hundred fifty basis points (2.50%) per annum, adjusted monthly on the first day of each month. The revolving credit facility expires on July 31, 2013. Under the revolving credit facility, we are permitted to borrow the lesser of $40,000,000 or the borrowing base, consisting of the sum of 85% of eligible accounts plus 60% of eligible inventory up to $17,000,000. Eligible accounts are generally those receivables that are less than 90 days from the invoice date. As security for the revolving credit facility, we provided Fifth Third Bank a first priority security interest in the accounts receivable from most of our customers and in our inventory. We also cross collateralized the revolving line of credit with the $8,800,000 term loan. As of September 30, 2010, the outstanding balance of the revolving line of credit was $40,000,000.

The $8,800,000 term loan provides for an interest rate that is the same as the interest rate for the revolving credit facility. Principal and interest is payable monthly in consecutive equal installments of $105,000, with the first such payment commencing September 1, 2010 and the final payment of the then-unpaid balance due and payable in full on July 31, 2013. In addition, beginning April 30, 2011 (or, if earlier, upon completion of the Company s financial statements for the fiscal year ending December 31, 2010), we will make an annual payment equal to 25% of (i) our adjusted earnings before interest, taxes, depreciation and amortization (EBITDA), minus (ii) our aggregate cash payments of interest expense and scheduled payments of principal (including any prepayments of the term loan), minus (iii) any non-financed capital expenditures, in each case for the Company s prior fiscal year. Any such payments will be applied to remaining installments of principal under the term loan in the inverse order of maturity, and to accrued but unpaid interest thereon. As security for the term loan, we provided Fifth Third Bank a first priority security interest in all equipment other than the rental fleet that we own. As of September 30, 2010, the outstanding balance of the term loan was $8,590,000.

In addition, we provided a first mortgage on the property at the following locations: 3409 Campground Road, 6709, 7023, 7025, 7101, 7103, 7110, 7124, 7200 and 7210 Grade Lane, Louisville Kentucky, 1565 East Fourth Street, Seymour, Indiana and 1617 State Road 111, New Albany, Indiana. The Company also cross collateralized the term loan with the revolving credit facility and all other existing debt the Company owes to Fifth Third Bank.

In the Credit Agreement, we agreed to certain covenants, including (i) maintenance of a ratio of debt to adjusted EBITDA for the preceding 12 months of not more than 3.5 to 1 (or, if measured as of December 31 of any fiscal year, 4.0 to 1), (ii) maintenance of a ratio of adjusted EBITDA for the preceding twelve months to aggregate cash payments of interest expense and scheduled payment of principal in the preceding 12 months of not less than 1.20 to 1, and (iii) a limitation on capital expenditures of $4,000,000 in any fiscal year. As of September 30, 2010, we were in compliance with all covenants.

See also Subsequent Events under Note 1 Summary of Significant Accounting Policies for information regarding a new promissory note entered into on October 19, 2010.

We entered into three interest rate swap agreements swapping variable rates for fixed rates. The first swap agreement covers approximately $5.3 million in debt and commenced April 7, 2009 and matures on April 7, 2014. The second swap agreement covers approximately $2.4 million in debt and commenced October 15, 2008 and matures on May 7, 2013. The third swap agreement covers approximately $522,000 in debt and commenced October 22, 2008 and matures on October 22, 2013. The three swap agreements fix our interest rate at approximately 5.8%. At September 30, 2010, we recorded the estimated fair value of the liability related to the three swaps at approximately $781,000. We entered into the swap agreements for the purpose of hedging the interest rate market risk for the respective notional amounts. These swap agreements were not affected by the debt restructuring with Fifth Third Bank. We maintain a cash account on deposit with BB&T which serves as collateral for the swap agreements.

Our long term debt as of September 30, 2010 and December 31, 2009 consisted of the following:

	2010	2009
	(unaudited)	
Revolving credit facility of $40 million with Fifth Third Bank. See above description for additional details. This credit facility replaced the April 13, 2010 BB&T non-revolving line of credit and revolving credit facility discussed below.	$ 40,000,000	$
Note payable to Fifth Third Bank the amount of $8.8 million secured by our rental fleet equipment, our shredder system assets, and a crane. See above description for additional details. This note payable replaced the BB&T $6 million, $3 million, and $609,900 notes payable listed below.	8,590,000	

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Non-revolving line of credit with BB&T effective February 11, 2009 in the amount of $12,000,000 with an original maturity date of February 11, 2010, which was extended to March 24, 2010, then to April 13, 2013 under a new BB&T loan agreement, and then was replaced by the Fifth Third revolving credit facility effective July 30, 2010. Interest was payable monthly starting March 11, 2009, and the note bore interest at the adjusted LIBOR rate of one month LIBOR plus 2.25% per annum with a floor of 4%. All our assets (except rental fleet equipment) secured this note.		11,517,440
Revolving credit facility of $10 million with BB&T secured by all assets except for rental fleet equipment with a variable interest rate of Libor plus 2.25% and no required monthly principal payments. The original maturity date under this agreement was January 1, 2012. This note extended to April 13, 2013 under a new BB&T loan agreement, and was replaced by the Fifth Third revolving credit facility effective July 30, 2010.		8,166,917
Note payable to BB&T in the amount of $3 million secured by our rental fleet equipment with a fixed interest rate of 5.65%. The repayment terms were principal and interest paid monthly commencing on November 7, 2008 with one final payment of all remaining principal and accrued interest due at maturity on May 7, 2013. This note was replaced by the Fifth Third note payable effective July 30, 2010.		2,598,526
Note payable to BB&T in the amount of $6.0 million secured by our shredder system assets with a fixed interest rate of 5.89%. The repayment terms were principal and interest paid monthly commencing on November 7, 2008 with one final payment of all remaining principal and accrued interest due at maturity on April 7, 2014. This note was replaced by the Fifth Third note payable effective July 30, 2010.		5,661,275
Note payable to BB&T in the amount of $609,900 secured by a crane with a fixed interest rate of 5.89%. The repayment terms were principal and interest paid monthly beginning December 1, 2008 with one final payment of all remaining principal and accrued interest due at maturity in December 2013. This note was replaced by the Fifth Third note payable effective July 30, 2010.		555,215
Note payable to Paccar Financial Corp. in the amount of $163,655 secured by one Kenworth truck. Payments are $1,697.68 per month with an effective interest rate of 6.5%. The maturity date under this agreement is September 2011.	41,083	112,724
Note payable to ILS for various assets including tractor trailers, trucks and containers. The repayment terms are $20,000 per month for 60 months at a seven percent (7%) interest rate. The maturity date under this agreement is August 2012.	429,308	582,273
	49,060,391	29,194,370
Less current maturities	1,517,900	12,539,889
	$ 47,542,491	$ 16,654,481

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The annual maturities of long-term debt as of September 30, 2010 are as follows:

2010	$ 1,517,900
2011	1,472,491
2012	6,070,000
2013	40,000,000
Total	$ 49,060,391

NOTE 5 SEGMENT INFORMATION

Our operations include two primary segments: Recycling and Waste Services.

The Company s two reportable segments are determined by the products and services that each offers. The Recycling segment generates its revenues based on buying and selling of ferrous, non-ferrous, including stainless steel, and fiber scrap. Waste Services revenues consist of charges to customers for waste disposal services and equipment sales and lease income. The components of the column labeled other are selling, general and administrative expenses that are not directly related to the two primary segments.

We evaluate segment performance based on gross profit or loss and the evaluation process for each segment includes only direct expenses and selling, general and administrative costs, omitting any other income and expense and income taxes.

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010	RECYCLING	WASTE SERVICES	OTHER	SEGMENT TOTALS
Recycling revenues	$ 237,093,814	$	$	$ 237,093,814
Equipment sales, service and leasing revenues		1,609,175		1,609,175
Management fees		4,831,239		4,831,239
Cost of goods sold	(217,023,116)	(5,105,016)		(222,128,132)
Selling, general and administrative expenses	(5,255,258)	(753,214)	(4,640,880)	(10,649,352)
Segment profit (loss)	$ 14,815,440	$ 582,184	$ (4,640,880)	$ 10,756,744
Segment assets	$ 102,505,501	$ 2,454,457	$ 2,325,422	$ 107,285,380

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009	RECYCLING	WASTE SERVICES	OTHER	SEGMENT TOTALS
Recycling revenues	$ 136,029,879	$	$	$ 136,029,879
Equipment sales, service and leasing revenues		1,593,434		1,593,434
Management fees		5,720,398		5,720,398
Cost of goods sold	(123,725,378)	(4,969,014)		(128,694,392)
Selling, general and administrative expenses	(4,488,417)	(1,031,862)	(2,235,741)	(7,756,020)

Segment profit (loss)	$ 7,816,084	$ 1,312,956	$ (2,235,741)	$ 6,893,299
Segment assets	$ 63,361,309	$ 3,115,724	$ 3,575,266	$ 70,052,299

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2010	RECYCLING	WASTE SERVICES	OTHER	SEGMENT TOTALS
Recycling revenues	$ 74,289,020	$	$	$ 74,289,020
Equipment sales, service and leasing revenues		499,691		499,691
Management fees		1,761,589		1,761,589
Cost of goods sold	(67,312,108)	(1,869,219)		(69,181,327)
Selling, general and administrative expenses	(1,833,582)	(232,820)	(1,817,657)	(3,884,059)
Segment profit (loss)	$ 5,143,330	$ 159,241	$ (1,817,657)	$ 3,484,914
Segment assets	$ 102,505,501	$ 2,454,457	$ 2,325,422	$ 107,285,380

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2009	ISA RECYCLING	WASTE SERVICES	OTHER	SEGMENT TOTALS
Recycling revenues	$ 77,877,987	$	$	$ 77,877,987
Equipment sales, service and leasing revenues		538,791		538,791
Management fees		1,552,696		1,552,696
Cost of goods sold	(72,294,051)	(1,161,980)		(73,456,031)
Selling, general and administrative expenses	(1,577,366)	(321,661)	(707,449)	(2,606,476)
Segment profit (loss)	$ 4,006,570	$ 607,846	$ (707,449)	$ 3,906,967
Segment assets	$ 63,361,309	$ 3,115,724	$ 3,575,266	$ 70,052,299

NOTE 6 INVENTORIES

Our inventories primarily consist of ferrous and non-ferrous, including stainless steel, scrap metals and are valued at the lower of average purchased cost or market. Beginning in 2010, we refined this method of valuing inventory to the specific identification method, whereas in all prior years inventory is valued using the weighted average method. This enhancement became available due to a change in the inventory software, which now provides the ability to specifically track and identify individual scrap metal commodities within the system. This improvement provides a more accurate value of the inventory and will apply for all future periods. Quantities of inventories are determined based on our inventory systems and are subject to periodic physical verification using estimation techniques including observation, weighing and other industry methods. We would recognize inventory impairment when the market value, based upon current market pricing, falls below recorded value or when the estimated volume is less than the recorded volume of the inventory. We would record the loss in cost of goods sold in the period during which we identified the loss.

Some commodities are in saleable condition at acquisition. We purchase these commodities in small amounts until we have a truckload of material available for shipment. Some commodities are not in saleable condition at acquisition. These commodities must be shredded, torched, sheared or baled. We do not have work-in-process inventory that needs to be manufactured to become finished goods. We include processing costs in inventory for all commodities.

Stainless steel inventory of $23,517,092 at September 30, 2010 was comprised only of raw materials. Ferrous inventory of $4,590,019 at September 30, 2010 was comprised of $4,076,375 in raw materials and $513,644 in finished goods. Non-ferrous inventory of $1,540,705 at September 30, 2010 was comprised of $471,927 in raw materials and $1,068,778 of finished goods. Replacement parts inventory for the shredder at September 30, 2010 was $1,118,862. Stainless steel inventory of $21,549,014 at December 31, 2009 was comprised only of raw materials. Ferrous inventory of $1,587,475 at December 31, 2009 was comprised of $269,344 in raw materials and $1,318,131 of finished goods. Non-ferrous inventory of $2,219,137 at December 31, 2009 was comprised of $653,019 in raw materials and $1,566,118 of finished goods. Replacement parts inventory for the shredder at December 31, 2009 was $879,831. Processing costs in inventory total $699,298 for the nine months ended September 30, 2010 and $611,372 for the year ended December 31, 2009.

Inventory also includes all types of industrial waste handling equipment and machinery held for resale such as compactors, balers, and containers. Other inventory includes cardboard and baling wire. Inventories as of September 30, 2010 and December 31, 2009 consist of the following:

	September 30, 2010 (unaudited)	December 31, 2009
Stainless steel alloys	$ 23,517,092	$ 21,549,014
Ferrous materials	4,590,019	1,587,475
Non-ferrous materials	1,540,705	2,219,137
Waste equipment machinery	83,989	102,032
Other	21,971	89,122
Total inventories for sale	29,753,776	25,546,780
Shredder replacement parts	1,118,862	879,831
Total inventories	$ 30,872,638	$ 26,426,611

NOTE 7 LEASES AND OTHER COMMITMENTS

Operating Leases:

We lease our Louisville, Kentucky facility from a related party under an operating lease expiring December 2012. The rent was adjusted in December 2007 per the agreement to make monthly payments of $48,500 through December 2012. In addition, we are also responsible for real estate taxes, insurance, utilities and maintenance expense.

We also lease a management services operations facility and various pieces of equipment in Dallas, Texas for which monthly payments of $969 are due through September 2011.

We also lease other machinery and equipment under operating leases which expire through January 2011.

2010	$ 650,148
2011	636,000
2012	159,000
Future minimum lease payments	$ 1,445,148

Total rent expense for the nine months ended September 30, 2010 and 2009 was $675,114 and $831,687, respectively.

Capital Leases:

We made the final payments for the equipment under capital leases in June 2010. We now own the equipment and no longer have any equipment under capital leases.

Other Commitments:

As of September 30, 2010, we had $842,344 committed for the purchase and installation of sensor sorter units, which amount was paid in full on October 19, 2010 with proceeds from the Promissory Note discussed in Note 1 Summary of Significant Accounting Policies Subsequent Events.

NOTE 8 PER SHARE DATA

The computation for basic and diluted earnings per share is as follows:

Nine months ended September 30, 2010 compared to nine months ended September 30, 2009:

	2010	2009
Basic earnings per share		
Net income	$ 6,033,085	$ 3,737,487
Weighted average shares outstanding	6,566,879	5,565,593
Basic earnings per share	$ 0.92	$ 0.67
Diluted earnings per share		
Net income	$ 6,033,085	$ 3,737,487
Weighted average shares outstanding	6,566,879	5,565,593
Add dilutive effect of assumed exercising of stock options	44,000	4,701
Diluted weighted average shares outstanding	6,610,879	5,570,294
Diluted earnings per share	$ 0.91	$ 0.67

Three months ended September 30, 2010 compared to three months ended September 30, 2009:

	2010	2009
Basic earnings per share		
Net income	$ 1,922,621	$ 2,161,214
Weighted average shares outstanding	6,784,917	5,850,633
Basic earnings per share	$ 0.28	$ 0.37
Diluted earnings per share		
Net income	$ 1,922,621	$ 2,161,214
Weighted average shares outstanding	6,784,917	5,850,633
Add dilutive effect of assumed exercising of stock options	50,563	13,952
Diluted weighted average shares outstanding	6,835,480	5,864,585
Diluted earnings per share	$ 0.28	$ 0.37

NOTE 9 LONG TERM INCENTIVE PLAN

At our June 10, 2010 annual shareholders meeting, shareholders approved the reservation of 1,200,000 additional shares of our common stock under our long term incentive plan so that the total number of shares reserved increased from 1,200,000 to 2,400,000. The plan makes available up to 2,400,000 shares of our common stock for performance-based awards under the plan. We may grant any of these types of awards: non-qualified and incentive stock options; stock appreciation rights; and other stock awards including stock units, restricted stock units, performance shares, performance units, and restricted stock. The performance goals that we may use for such awards will be based on any one or more of the following performance measures: cash flow; earnings; earnings per share; market value added or economic value added; profits; return on assets; return on equity; return on investment; revenues; stock price; or total shareholder return.

The plan is administered by a committee selected by the Board, initially our Compensation Committee, and consisting solely of two or more outside members of the Board. The Committee may grant one or more awards to our employees, including our officers, our directors and consultants, and will determine the specific employees who will receive awards under the plan and the type and amount of any such awards. A participant who receives shares of stock awarded under the plan must hold those shares for six months before the participant may dispose of such shares. The Committee may settle an award under the plan in cash rather than stock.

As of July 1, 2009, we awarded options to purchase 30,000 shares of our stock each to our three independent directors for a total of 90,000 shares at a per share exercise price of $4.23. As of January 11, 2010, we awarded 18,000 shares of our stock to management at a per share price of $6.47 and as of February 11, 2010, we awarded 7,500 shares of our stock to management at a per share price of $6.73. As of June 8, 2010, we awarded 30,000 shares of our stock to Brian Donaghy at a per share price of $9.51.

NOTE 10 CERTAIN RELATED PARTY TRANSACTIONS

Effective July 1, 2010, the Company amended and restated the employment agreement of Steve Jones (Mr. Jones), the Company s Vice President of Operations ISA Alloys, to (a) extend the term to June 30, 2015, and (b) replace the annual bonus of a cash payment equal to 7.5% of the amount determined for each fiscal year of the segment profit of ISA Alloys minus selling, general and administrative expenses applicable to the ISA Alloys segment with (i) an annual bonus based on the Company s achievement of certain return on net assets

(RONA) targets pursuant to incentive plans to be established by the Company, to be payable in cash or partly in Common Stock, at the election of Mr. Jones. Also, as a result of the supplemental acquisition between the Company and Venture Metals, LLC (Venture), further discussed below, Mr. Jones is no longer entitled to: (i) a bonus of up to 45,000 shares of Common Stock per annum based on the Company s achievement of certain RONA targets, and (ii) a one-time bonus of up to 225,000 shares of Common Stock based on the Company s achievement of certain 5 year RONA targets as of December 31, 2014.

Effective July 1, 2010, the Company amended and restated the employment agreement of Jeffrey Valentine (Mr. Valentine), the Company s General Manager of ISA Alloys, to (a) extend the term to June 30, 2015, and (b) replace the annual bonus of a cash payment equal to 7.5% of the amount determined for each fiscal year of the segment profit of ISA Alloys minus selling, general and administrative expenses applicable to the ISA Alloys segment with (i) an annual cash bonus based on the Company s achievement of certain RONA targets pursuant to an incentive plan to be established by the Company. Also, as a result of the supplemental acquisition between the Company and Venture, Mr. Valentine is no longer entitled to: (i) a bonus of up to 45,000 shares of Common Stock per annum based on the Company s achievement of certain RONA targets, and (ii) a one-time bonus of up to 75,000 shares of Common Stock based on the Company s achievement of certain 5 year RONA targets as of December 31, 2014.

On June 16, 2010, the Company and Venture agreed to a supplemental acquisition dated July 1, 2010. Pursuant to this agreement, on April 12, 2010, the Company paid Venture $1,348,942 for commissions earned and accrued in 2009 using the line of credit facility and on July 1, 2010, issued to Venture 300,000 shares of Common Stock, in exchange for Venture s customer list, the Venture name, Venture s execution of a non-compete agreement, and Venture s agreement to cause Mr. Jones and Mr. Valentine to provide the company with non-compete agreements. Based on an independent appraisal, the Company shall deliver up to an additional 750,000 shares of ISA Common Stock in accordance with the following:

(a) Venture shall receive up to ninety thousand (90,000) shares of ISA common stock per annum commencing in 2011 for calendar year 2010, and thereafter in 2012, 2013, 2014, and 2015 for calendar years 2011, 2012, 2013, and 2014, respectively, resulting in a maximum of four hundred and fifty thousand (450,000) shares of ISA common stock over the such period (but in no event greater than 90,000 shares in any one calendar year) based on satisfaction of the RONA criteria set forth in Exhibit 10.3 attached hereto and incorporated herein by reference. Such consideration shall be payable in the form of ISA common stock in one delivery of a stock certificate, as soon as practicable following December 31, 2015 subject to applicable withholding and other taxes and other required deductions;

(b) Venture shall be entitled to receive additional consideration for the purchase of assets up to three hundred thousand (300,000) shares of ISA common stock based on satisfaction of the 5 year (2010-2014) average RONA criteria set forth in Exhibit 10.3 attached hereto and incorporated herein by reference. Such consideration shall be payable in the form of Company common stock in one delivery of a stock certificate, as soon as practicable following December 31, 2014 subject to applicable withholding and other taxes and other required deductions.

Venture is owned by Mr. Jones and Mr. Valentine.

We recorded other liabilities of $4,520,000 for the accrued liability representing the fair value of the contingent consideration associated with the purchase of the Venture Metals, LLC intangibles, as discussed in Note 2 Intangibles and Note 10 Certain Related Party Transactions.

NOTE 11   LEGAL PROCEEDINGS

We have litigation from time to time, including employee or former employee claims, none of which we believe to be material.

ITEM 2: MANAGEMENTS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis should be read in conjunction with our unaudited condensed consolidated financial statements and the accompanying notes thereto included elsewhere in this report.

The following discussion and analysis contains certain financial predictions, forecasts and projections which constitute forward-looking statements within the meaning of the federal securities laws. Actual results could differ materially from those financial predictions, forecasts and projections and there can be no assurance that we will achieve such financial predictions, forecasts and projections. Factors that could affect financial predictions, forecasts and projections include the fluctuations in the commodity price index and any conditions internal to our major customers, including loss of their accounts and other factors as listed in our Form 10-K for the year ended December 31, 2009, as filed with the Securities and Exchange Commission.

General

We are primarily focusing our attention now and in the future towards our recycling business. We sell processed ferrous and non-ferrous scrap material to end-users such as steel mini-mills, integrated steel makers, foundries and refineries. We purchase ferrous and non-ferrous scrap material primarily from industrial and commercial generators of steel, iron, aluminum, copper, stainless steel and other metals as well as from other scrap dealers who deliver these materials directly to our facilities. We process these materials by shredding, sorting, shearing, cutting and/or baling. We will also continue to focus on initiating growth in our management services business segment and our waste and recycling equipment sales, service and leasing division.

In 2009, we expanded into the stainless steel recycling market for super alloys and high temperature metals by purchasing inventories and related equipment from Venture Metals, LLC and hiring two of its key executives. We buy and sell stainless steel and high-temperature alloys to steel mills like North American Stainless, our primary customer. The Venture Metals asset purchase is the latest in a series of actions we have undertaken to position ourselves for strategic growth. The multi-million-dollar shredder project, completed in June 2009, expands our processing capacity, offers specialty grades of scrap and improves end-product quality. The shredder began operations on July 1, 2009. In the last quarter of 2009, we improved the Grade Lane location and added a new entrance for our ISA Alloys operations, which we moved from the Camp Ground Road location to 7100 Grade Lane in November 2009. In 2010, we hired an Alloys Operations Manager to aid in the expansion of specialty alloys within our recycling segment, specifically in the area of aerospace alloys. In July, 2010, we purchased certain Venture Metals, LLC intangibles, including the customer list and trade name, and entered into a non-compete agreement to protect our market position.

We continue to pursue a growth strategy in the waste management services arena by adding new locations of existing customers as well as marketing our services to potential customers. Currently, we service approximately 720 customer locations throughout the United States and we utilize an active database of over 6,500 vendors to provide timely, thorough and cost-effective service to our customers.

Although our focus is on the recycling industry, our goal is to remain dedicated to the management services, and equipment industry as well, while sustaining steady growth at an acceptable profit, adding to our net worth, and providing positive returns for stockholders. We intend to increase efficiencies and productivity in our core business while remaining alert for possible acquisitions, strategic partnerships, mergers and joint-ventures that would enhance our profitability.

We have operating locations in Louisville, Kentucky, Seymour, Indiana, New Albany, Indiana, and Dallas, Texas. We do not have operating locations outside the United States.

Liquidity and Capital Resources

As of September 30, 2010 we held cash and cash equivalents of $2,068,705.

On July 30, 2010, we entered into a Credit Agreement (the Credit Agreement) with Fifth Third Bank pursuant to which Fifth Third Bank agreed to provide us a revolving credit facility in the amount of $40,000,000 for the purpose of replacing the existing $20,000,000 senior revolving credit facility with Branch Banking and Trust Company (BB&T) and for payment of the $5,000,000 note payable to BB&T (collectively, the Prior Obligations). Proceeds of the new revolving credit facility in the amount of $33,355,003 were used to repay the outstanding principal balance of the Prior Obligations. We used additional proceeds of the revolving credit facility to pay closing costs and for funding temporary fluctuations in accounts receivable of most of our customers and inventory. In addition, we entered into a term loan agreement with Fifth Third Bank in the amount of $8,800,000 for the purpose of replacing the $6,000,000 note payable secured by our shredder system, the $3,000,000 note payable secured by our rental fleet equipment, and the $609,900 note payable secured by our crane.

With respect to the revolving credit facility, the interest rate is one month LIBOR plus two hundred fifty basis points (2.50%) per annum, adjusted monthly on the first day of each month. The revolving credit facility expires on July 31, 2013. Under the revolving credit facility, we are permitted to borrow the lesser of $40,000,000 or the borrowing base, consisting of the sum of 85% of eligible accounts plus 60% of eligible inventory up to $17,000,000. Eligible accounts are generally those receivables that are less than 90 days from the invoice date. As security for the revolving credit facility, we provided Fifth Third Bank a first priority security interest in the accounts receivable from most of our customers and in our inventory. We also cross collateralized the revolving line of credit with the $8,800,000 term loan. As of September 30, 2010, the outstanding balance on the revolving line of credit was $40,000,000.

The $8,800,000 term loan provides for an interest rate that is the same as the interest rate for the revolving credit facility. Principal and interest is payable monthly in consecutive equal installments of $105,000, with the first such payment commencing September 1, 2010 and the final payment of the then-unpaid balance due and payable in full on July 31, 2013. In addition, beginning April 30, 2011 (or, if earlier, upon completion of the Company s financial statements for the fiscal year ending December 31, 2010), we will make an annual payment equal to 25% of (i) our adjusted earnings before interest, taxes, depreciation and amortization (EBITDA), minus (ii) our aggregate cash payments of interest expense and scheduled payments of principal (including any prepayments of the term loan), minus (iii) any non-financed capital expenditures, in each case for the Company s prior fiscal year. Any such payments will be applied to remaining installments of principal under the term loan in the inverse order of maturity, and to accrued but unpaid interest thereon. As security for the term loan, we provided Fifth Third Bank a first priority security interest in all equipment other than the rental fleet that we own. As of September 30, 2010, the outstanding balance on the term loan was $8,590,000.

In addition, we provided a first mortgage on the property at the following locations: 3409 Campground Road, 6709, 7023, 7025, 7101, 7103, 7110, 7124, 7200 and 7210 Grade Lane, Louisville Kentucky, 1565 East Fourth Street, Seymour, Indiana and 1617 State Road 111, New Albany, Indiana. The Company also cross collateralized the term loan with the revolving credit facility and all other existing debt the Company owes to Fifth Third Bank.

In the Credit Agreement, we agreed to certain covenants, including (i) maintenance of a ratio of debt to adjusted EBITDA for the preceding 12 months of not more than 3.5 to 1 (or, if measured as of December 31 of any fiscal year, 4.0 to 1), (ii) maintenance of a ratio of adjusted EBITDA for the preceding twelve months to aggregate cash payments of interest expense and scheduled payment of principal in the preceding 12 months of not less than 1.20 to 1, and (iii) a limitation on capital expenditures of $4,000,000 in any fiscal year.

On October 19, 2010, we entered into a Promissory Note (the Note) with Fifth Third Bank in the amount of $1,320,240 for the purpose of purchasing equipment. The interest rate is equal to five and 20/100 percent (5.20%) per annum; provided, however, that (A) such interest rate is based on an interest rate swap rate for a term approximating the weighted average life of the Note as quoted in the Bloomberg SWAP Rate report as of the date of the Note and (B) such interest rate may be adjusted by Fifth Third Bank based upon a corresponding increase in the interest rate swap rate quoted in such Release as in effect on the date of the advance. Principal and interest is payable monthly in consecutive equal installments of $30,511 with the first such payment commencing November 15, 2010, and the final unpaid principal amount due, together with all accrued and unpaid interest, charges, fees, or other advances, if any, to be paid on October 15, 2014. As security for the Note, we provided Fifth Third Bank a first priority security interest in the equipment purchased with the proceeds.

We have long term debt comprised of the following:

	September 30, 2010 (unaudited)	December 31, 2009
Non-revolving line of credit	$	$ 11,517,440
Revolving line of credit	40,000,000	8,166,917
Notes payable	9,060,391	9,510,013
Total debt	$ 49,060,391	$ 29,194,370

As of September 30, 2010, we were in compliance with all restrictive covenants related to our debt.

We expect that existing cash flow from operations and available credit under our restructured credit facilities and other alternative financing will be sufficient to meet our cash needs for the next year and beyond. As of September 30, 2010, we had $842,344 committed for the purchase and installation of sensor sorter units, which was paid in full on October 19, 2010 with proceeds from the Note discussed above.

Results of Operations

The following table presents, for the years indicated, the percentage relationship that certain captioned items in our Consolidated Statements of Operations bear to total revenues and other pertinent data:

	Nine months ended September 30,	
	2010	2009
Statements of Operations Data:		
Total Revenue	100.0%	100.0%
Cost of goods sold	91.2%	89.8%
Selling, general and administrative expenses	4.2%	5.4%
Income before other expenses	4.6%	4.8%

Nine months ended September 30, 2010 compared to nine months ended September 30, 2009

Total revenue increased $100,190,517 or 70.0% to $243,534,228 in 2010 compared to $143,343,711 in 2009. Recycling revenue increased $101,063,935 or 74.3% to $237,093,814 in 2010 compared to $136,029,879 in 2009. This is primarily due to the improvements and expansions of our Grade Lane facilities made in late 2009 and the increased production from the shredder, which began production in July 2009, along with a 3.3% increase in volume of stainless steel materials shipments, a 122.4% increase in volume of ferrous materials shipments, a 16.1% increase in volume of other nonferrous materials shipments, and an average increase in cost of commodities shipped of 53.4%. Waste Services revenue decreased $873,418 or 11.9% to $6,440,414 in 2010 compared to $7,313,832 in 2009 primarily due to the year-over-year decrease in customer locations, as well as a $153,004 decrease in rental revenue, partially offset by a $147,702 increase in equipment and parts sales and service and repairs revenue.

Total cost of goods sold increased $93,348,562 or 75.1% to $222,128,133 in 2010 compared to $128,694,392 in 2009. Recycling cost of goods sold increased $93,297,738 or 75.4% to $217,023,116 in 2010 compared to $123,725,378 in 2009. This is primarily due to the increases in volume of shipments and commodity prices noted above. Waste Services cost of goods sold increased $136,002 or 2.7% to $5,105,016 in 2010 compared to $4,969,014 in 2009 primarily due to an increase of $118,295 in cost of equipment and parts sales, service and repairs, hauling, and commissions.

Selling, general and administrative expenses increased $2,893,332 or 37.3% to $10,649,352 in 2010 compared to $7,756,020 in 2009. As a percentage of revenue, selling, general and administrative expenses were 4.4% in 2010 compared to 5.4% in 2009. The primary drivers of the increase in total expenses are an increase in stock bonus and bonus expense of $1,917,895, an increase in labor/management-related expenses (labor and associated taxes, consulting, management fees, employment fees and employee training, and insurance benefits) of $424,629, an increase in legal fees, insurance expense, compliance and reporting expenses, bank charges, and property taxes of $266,534, an increase in operating supplies and computer software and equipment of $176,044, an increase in repairs/maintenance and fuel/lubricants expenses of $103,077, and amortization expense of $67,500, partially offset by a decrease in lease/rent, accounting, and bad debt expenses of $136,330.

Other expense increased $37,447 to other expense of $701,601 in 2010 compared to other expense of $664,154 in 2009. This was primarily due to an increase in interest expense of $319,694, partially offset by an increase in the gain on sale of assets of $202,932 and an increase in other income of $83,296.

Income tax provision increased $1,530,399 to $4,022,057 in 2010 compared to $2,491,658 in 2009. The effective tax rate in 2010 and 2009 was 40.0% based on federal and state statutory rates.

Three months ended September 30, 2010 compared to three months ended September 30, 2009

Total revenue decreased $3,419,174 or 4.3% to $76,550,300 in 2010 compared to $79,969,474 in 2009. Recycling revenue decreased $3,588,967 or 4.6% to $74,289,020 in 2010 compared to $77,877,987 in 2009. This is primarily due to a decrease in stainless steel shipments of 35.9%, partially offset by an increase in ferrous shipments of 66.3%, an increase in nonferrous shipments of 4.6%, and an average increase in cost of commodities shipped of 32.7%. Waste Services revenue increased $169,793 or 8.1% to $2,261,280 in 2010 compared to $2,091,487 in 2009 primarily due to a $236,894 increase in cardboard revenue due to increased cardboard prices. This increase was partially offset by a $79,953 decrease in management fee revenue, and a $61,069 decrease in rental revenue.

Total cost of goods sold decreased $4,274,704 or 5.8% to $69,181,327 in 2010 compared to $73,456,031 in 2009. Recycling cost of goods sold decreased $4,981,943 or 6.9% to $67,312,108 in 2010 compared to $72,294,051 in 2009. This is primarily due to the decrease in volume of shipments noted above, partially offset by the increase in commodity prices noted above. Waste Services cost of goods sold increased $707,238 or 60.9% to $1,869,218 in 2010 compared to $1,161,980 in 2009 primarily due to a decrease of $462,027 in bankruptcy-related write offs in 2010 compared to 2009 and the increase in cardboard prices.

Selling, general and administrative expenses increased $1,277,583 or 49.0% to $3,884,059 in 2010 compared to $2,606,476 in 2009. As a percentage of revenue, selling, general and administrative expenses were 5.1% in 2010 compared to 3.3% in 2009. The primary drivers of the increase in total expense are increases in stock bonus and bonus expense of $1,021,892, labor/management-related expenses (labor and associated taxes, consulting, management fees, employment fees and employee training, and insurance benefits) of $116,808, operating supplies, computer software and equipment, and fuel and lubricants of $106,813, and amortization expense of $67,500, partially offset by decreases in repairs and maintenance and accounting of $32,609.

Other expense decreased $24,398 to other expense of $280,546 in 2010 compared to other expense of $304,944 in 2009 primarily due to an increase in other income of $46,519, partially offset by a decrease in gain on sale of assets of $20,244.

Income tax provision decreased $159,062 to $1,281,747 in 2010 compared to $1,440,809 in 2009. The effective tax rate in 2010 and 2009 was 40.0% based on federal and state statutory rates.

Financial condition at September 30, 2010 compared to December 31, 2009

Cash and cash equivalents increased $1,355,643 to $2,068,705 as of September 30, 2010 compared to $713,062 as of December 31, 2009.

Intangibles increased from $0 to $6,712,500 due to the purchase of the Venture Metals, LLC customer list and trade name, and the non-compete agreement with Venture and its owners, totaling $6,780,000. This increase was reduced by $67,500 due to amortization.

Net cash used in operating activities of $11,394,483 for the nine months ended September 30, 2010 is primarily due to increases in accounts receivable, inventories and other assets, partially offset by increases in accounts payable and income tax payable. The increases in accounts receivable and accounts payable are due to a combination of increased shipments, purchases, and commodity prices.

We used net cash in investing activities of $2,095,097 for the nine months ended September 30, 2010. We used $456,073 for road and building improvements. We purchased recycling and rental fleet equipment, shredder system equipment, and shear parts for a total of $1,274,495. The rental fleet equipment consists of solid waste handling and recycling equipment such as compactors, containers and balers. It is our intention to continue to pursue this market. Additionally, we spent $113,576 on accounting software and computer equipment. We also purchased vehicles for $26,657. We received $351,109 from sales of our rental fleet compactors, balers, containers, and trucks. We paid deposits of $605,711 on machinery and equipment.

Net cash from financing activities of $14,845,223 for the nine months ended September 30, 2010 is due to the new debt from Fifth Third Bank of $48,800,000, partially offset by payments of $33,499,373 to pay off the BB&T debt, and payments on other debt and capital lease obligations of $434,606 and $20,798, respectively.

Accounts receivable trade increased $27,658,043 to $36,170,369 as of September 30, 2010 compared to

$8,512,326 as of December 31, 2009. This change is due to a combination of increased shipments due to the shredder operations being fully functional in 2010 and an increase in commodity prices.

Inventories consist principally of stainless steel, ferrous and nonferrous scrap materials and waste equipment machinery held for resale. We value inventory at the lower of cost or market. Inventory increased $4,446,027 or 16.8% to $30,872,638 as of September 30, 2010 compared to $26,426,611 as of December 31, 2009. The primary reason for the increase was that the average cost of commodities shipped out of inventory year-to-date was higher than the average cost of commodities purchased year-to-date and the volume of purchases were higher than the volume of shipments for the year and quarter.

Inventory aging for the period ended September 30, 2010 (Days Outstanding):

Description	1-30	31-60	61-90	Over 90	Total
Stainless steel alloys	$ 14,762,378	$ 7,268,233	$ 399,353	$ 1,087,128	$ 23,517,092
Ferrous materials	1,883,301	161,575	27,114	2,518,029	4,590,019
Non-ferrous materials	1,366,410	85,117	12,934	76,244	1,540,705
Waste equipment machinery	18,189	10,850		54,950	83,989
Other	21,971				21,971
Total inventories for sale	18,052,249	7,525,775	439,401	3,736,351	29,753,776
Shredder replacement parts	1,118,862				1,118,862
	$ 19,171,111	$ 7,525,775	$ 439,401	$ 3,736,351	$ 30,872,638

Inventory aging for the period ended December 31, 2009 (Days Outstanding):

Description	1-30	31-60	61-90	Over 90	Total
Stainless steel alloys	$ 11,738,653	$ 2,564,183	$ 5,170,224	$ 2,075,954	$ 21,549,014
Ferrous materials	1,513,849	47,151	19,834	6,641	1,587,475
Non-ferrous materials	1,801,125	243,708	47,545	126,759	2,219,137
Waste equipment machinery	9,670			92,362	102,032
Other	89,122				89,122
Total inventories for sale	15,152,419	2,855,042	5,237,603	2,301,716	25,546,780
Shredder replacement parts	879,831				879,831
	$ 16,032,250	$ 2,855,042	$ 5,237,603	$ 2,301,716	$ 26,426,611

Accounts payable trade increased $10,023,047 or 214.0% to $14,707,433 as of September 30, 2010 compared to $4,684,386 as of December 31, 2009, primarily due to a 62.8% increase in commodity prices.

Working capital increased $37,252,394 to $48,571,079 as of September 30, 2010 compared to $11,318,685 as of December 31, 2009. The increase was primarily driven by the $27.7 million increase in accounts receivable, the $4.4 million increase in inventory, the debt restructuring, which reclassified $16.0 million in current maturities to long-term debt, and the $1.4 million increase in cash. These increases were partially offset by the $10.0 million increase in accounts payable, and the $1.7 million increase in income taxes payable.

Contractual Obligations

The following table provides information with respect to our known contractual obligations for the quarter ended September 30, 2010.

Obligation Description	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt Obligations	$ 49,060,391	$ 1,517,900	$ 7,542,491	$ 40,000,000	$
Operating Lease Obligations (1)	1,445,148	650,148	795,000		
Total	$ 50,505,539	$ 2,168,048	$ 8,337,491	$ 40,000,000	$

(1) We lease the Louisville, Kentucky facility from K&R, LLC, the sole member of which is Harry Kletter, our chief executive officer, under an operating lease expiring December 2012. We have monthly rental payments of $48,500 through December 2012. In the event of a change of control, the monthly payments become $62,500. We have subleased the Lexington property to an unaffiliated third party for a term commencing March 1, 2007 and ending December 31, 2012 for $4,500 per month. We currently lease this property from an unrelated party for $4,500 per month; the lease terminates December 31, 2012. If for any reason the sub-lessee defaults, we remain liable for the remainder of the lease payments through December 31, 2012.

We also lease a management services operations facility and various pieces of equipment in Dallas, Texas for which monthly payments of $969 are due through September 2011.

Long-term debt, including the current portions thereof, increased $14,866,021 to $49,060,391 as of September 30, 2010 compared to $34,194,370 as of December 31, 2009.

Impact of Recently Issued Accounting Standards

In 2008 the FASB issued authoritative guidance on disclosures about derivative instruments and hedging activities and updated this guidance in February 2010 through guidance entitled Technical Corrections to Various Topics . The guidance amends and expands the disclosure requirements in the previously issued guidance on accounting for derivative instruments and hedging activities and was effective for fiscal years and interim periods beginning after November 15, 2008, the year beginning January 1, 2009 for us. The February 2010 update was effective for the first reporting period beginning after issuance, the year ending December 31, 2009 for us. We have included the required disclosures in Note 4 of our Condensed Consolidated Financial Statements.

In May 2009, the FASB issued authoritative guidance on subsequent events, but this guidance was amended by new authoritative guidance issued in February, 2010. The original guidance required the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date that is, whether that date represents the date the financial statements were issued or were available to be issued. The new guidance removes the requirement for an SEC filer to disclose a date in both issued and revised financial statements. This amendment removes potential conflicts with SEC requirements. The original guidance became effective for interim and annual periods ending after June 15, 2009, the quarter ending June 30, 2009 for us, and the amendment became effective upon issuance of the final update in February, 2010.

The FASB issued authoritative guidance on accounting for transfers of financial assets in June 2009 with an update issued in December 2009. This guidance is effective for reporting periods beginning after November 15, 2009, the year ending December 31, 2010 for us. This new guidance limits the circumstances in which a financial asset may be de-recognized when the transferor has not transferred the entire financial asset or has continuing involvement with the transferred asset. The concept of a qualifying special-purpose entity, which had previously facilitated sale accounting for certain asset transfers, is removed by this new guidance. The adoption of this new guidance did not impact our financial position or results of operations.

The FASB issued authoritative guidance on accounting for variable interest entities (VIE) in June 2009 with an update issued in December 2009. This guidance is effective for reporting periods beginning after November 15, 2009, the year ending December 2010 for us. This guidance changes the process for how an enterprise determines which party consolidates a VIE, to a primarily qualitative analysis. The party that consolidates the VIE (the primary beneficiary) is defined as the party with (1) the power to direct activities of the VIE that most significantly affect the VIE s economic performance and (2) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE. Upon adoption, reporting enterprises must reconsider their conclusions on whether an entity should be consolidated and should a change result, the effect on net assets will be recorded as a cumulative effect adjustment to retained earnings. The adoption of this new guidance did not impact our financial position or results of operations.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Fluctuating commodity prices affect market risk in our recycling segment. We mitigate this risk by selling our product on a monthly contract basis. Each month we negotiate selling prices for all commodities. Based on these monthly agreements, we determine purchase prices based on a margin needed to cover processing and administrative expenses.

We are exposed to commodity price risk, mainly associated with variations in the market price for ferrous and nonferrous metal, and other commodities. The timing and magnitude of industry cycles are difficult to predict and are impacted by general economic conditions. We respond to changes in recycled metal selling prices by adjusting purchase prices on a timely basis and by turning rather than holding inventory in expectation of higher prices. However, financial results may be negatively impacted where selling prices fall more quickly than purchase price adjustments can be made or when levels of inventory have an anticipated net realizable value that is below average cost.

We are exposed to interest rate risk on our floating rate borrowings. On July 30, 2010, we entered into a Credit Agreement (the Credit Agreement) with Fifth Third Bank pursuant to which Fifth Third Bank agreed to provide us a revolving credit facility in the amount of $40,000,000 for the purpose of replacing the existing $20,000,000 senior revolving credit facility with Branch Banking and Trust Company (BB&T) and for payment of the $5,000,000 note payable to BB&T (collectively, the Prior Obligations). Proceeds of the new revolving credit facility in the amount of $33,355,003 were used to repay the outstanding principal balance of the Prior Obligations. We used additional proceeds of the revolving credit facility to pay closing costs and for funding temporary fluctuations in accounts receivable of most of our customers and inventory. In addition, we entered into a term loan agreement with Fifth Third Bank in the amount of $8,800,000 for the purpose of replacing the $6,000,000 note payable secured by our shredder system, the $3,000,000 note payable secured by our rental fleet equipment, and the $609,900 note payable secured by our crane. Based on our average anticipated borrowings under our credit agreements in fiscal 2010, a hypothetical increase or decrease in the LIBOR rate by 1% would increase or decrease interest expense on our variable borrowings by 1% of the outstanding balance, with a corresponding change in cash flows.

We entered into three interest rate swap agreements swapping variable rates for fixed rates. The first swap agreement covers approximately $5.3 million in debt and commenced April 7, 2009 and matures on April 7, 2014. The second swap agreement covers approximately $2.4 million in debt and commenced October 15, 2008 and matures on May 7, 2013. The third swap agreement covers approximately $522,000 in debt and commenced October 22, 2008 and matures on October 22, 2013. The three swap agreements fix our interest rate at approximately 5.8%. At September 30, 2010, we recorded the estimated fair value of the liability related to the three swaps as approximately $781,000. Accounting rules require us to recognize all derivatives on the balance sheet at estimated fair value. We have designated these agreements as a cash flow hedge. These swap agreements were not affected by the debt restructuring with Fifth Third Bank. We maintain a cash account on deposit with BB&T which serves as collateral for the swap agreements.

We are exposed to market risk from changes in interest rates in the normal course of business. Our interest income and expense are most sensitive to changes in the general level of U.S. interest rates and the LIBOR rate. In order to manage this exposure, we use a combination of debt instruments, including the use of derivatives in the form of interest rate swap agreements. We do not enter into any derivatives for trading purposes. The use of the interest rate swap agreement is intended to convert the variable rate to a fixed rate.

ITEM 4: CONTROLS AND PROCEDURES

(a) Disclosure controls and procedures.

ISA s management, including ISA s principal executive officer and principal financial officer, have evaluated the effectiveness of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934. Based upon their evaluation, our principal executive officer and principal financial officer concluded that, as of September 30, 2010, ISA s disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that ISA files under the Exchange Act with the Securities and Exchange Commission (1) is recorded, processed, summarized and reported within the time periods specific in the SEC s rules and forms, and (2) is accumulated and communicated to ISA s management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding the required disclosure.

(b) Changes to internal control over financial reporting

There were no changes in ISA s internal control over financial reporting during the three months ended September 30, 2010 that have materially affected, or are reasonably likely to affect ISA s internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Lennox Industries, Inc. v. Industrial Services of America, Inc., case No. CV-2007-004 is pending in the Circuit Court of Arkansas County, at Stuttgart, Arkansas. Lennox Industries, Inc. (hereafter Lennox) has reduced its legal theories against ISA in a Second Amended Complaint. It now alleges breach of contract, negligence, and breach of fiduciary duty arising from ISA s alleged miscategorization of Lennox s scrap metal and mismanagement of the scrap metal recycling operations at three Lennox plants during the contract period April 18, 2001 through November 2005.

We filed a Motion for Summary Judgment in October 2009, which the court denied in February 2010. Discovery by the parties is still ongoing. There are currently no dates set for either a mediation or a jury trial, however, one or both of these developments will likely occur in early to mid-2011. ISA is vigorously defending

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all of Lennox s claims. It is our position that the claims are legally and factually without merit.

Item 1A. Risk Factors

We have had no material changes from the risk factors reported in our Form 10-K for the year ended December 31, 2009, as filed with the Securities and Exchange Commission on March 22, 2010.

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

On July 1, 2010, we issued 300,000 shares of stock in exchange for the Venture Metals, LLC (Venture) customer list and name, Venture s execution of a non-compete agreement, and Venture s agreement to cause Mr. Jones and Mr. Valentine to provide the company with non-compete agreements. The issuance of shares to Venture was exempt under Section 4(2) of the Securities Act of 1933, as amended.

On November 15, 2005, our Board of Directors authorized a program to repurchase up to 300,000 shares of our common stock at current market prices. No shares were repurchased in 2010 or 2009. In 2008, we repurchased 83,411 shares. In 2007, we repurchased 60,000 shares. In 2006, we repurchased 8,264 shares, and in 2005 we repurchased 15,000 shares.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as part of Publicly Announced Plans or Programs	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
Mar-08	29,630	$ 5.5215	112,893	187,107
Jun-08	14,781	$ 7.6113	127,674	172,326
Sept-08	39,000	$ 6.5268	166,674	133,326

Item 3. Defaults upon Senior Securities

None.

Item 4. Removed and Reserved

Item 5. Other Information

None.

Item 6. Exhibits

See exhibit index.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	INDUSTRIAL SERVICES OF AMERICA, INC.
Date: November 10, 2010	/s/ Harry Kletter
	Chairman and Chief Executive Officer (Principal Executive and Financial Officer)
Date: November 10, 2010	/s/ Alan Schroering
	Chief Financial Officer

INDEX TO EXHIBITS

Exhibit Number	Description of Exhibits
31.1	Rule 13a-14(a) Certification of Harry Kletter for the Form 10-Q for the quarter ended September 30, 2010.
31.2	Rule 13a-14(a) Certification of Alan Schroering for the Form 10-Q for the quarter ended September 30, 2010.
32.1	Section 1350 Certification of Harry Kletter and Alan Schroering for the Form 10-Q for the quarter ended September 30, 2010.