

INDUSTRIAL SERVICES OF AMERICA INC /FL
Form 10-K
March 07, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

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

For Fiscal Year Ended December 31, 2011

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.: 0-20979

INDUSTRIAL SERVICES OF AMERICA, INC.

(Exact name of registrant as specified in its charter)

Florida

(State or other jurisdiction of
incorporation or organization)

7100 Grade Lane
P.O. Box 32428

Louisville, Kentucky

(Address of Principal Executive Offices)

59-0712746

(I.R.S. Employer
Identification No.)

40232
(Zip Code)

Registrant's Telephone Number, Including Area Code: (502) 368-1661

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

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

Common Stock, \$0.0033 par value
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes 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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

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 (Section 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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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.

1

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

(Check one): Large accelerated filer Accelerated filer
Non-accelerated filer 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

Aggregate market value of the 4,589,593 shares of voting Common Stock held by non-affiliates of the registrant at the closing sales price on June 30, 2011: \$48,420,206.

Number of shares of Common Stock, \$0.0033 par value, outstanding as of the close of business on March 7, 2012: 6,940,517.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2012 Annual Meeting of Shareholders are incorporated by reference into Item 10 through Item 14 of Part III of this report.

PART I

Item 1. Business.
General

Industrial Services of America, Inc. (herein ISA, the Company, we, us, our, or other similar terms), is a Louisville, Kentucky-based recycler of stainless steel, ferrous, and non-ferrous scrap and provider of waste services. Although we have two principal business segments, recycling and waste services, we are primarily focusing our attention now and in the future towards our recycling business. The recycling segment collects, purchases, processes and sells stainless steel, ferrous and non-ferrous scrap metal to steel mini-mills, integrated steel makers, foundries and refineries. We purchase ferrous and non-ferrous scrap metal primarily from industrial and commercial generators of steel, iron, aluminum, copper, stainless steel and other metals as well as from scrap dealers and retail customers who deliver these materials directly to our facilities. We process scrap metal through our shredding, sorting, shearing, cutting, and baling operations. Within the recycling segment, our alloys division specializes in the purchasing, processing and sale of stainless steel, nickel-based and high-temperature alloys. Our non-ferrous scrap recycling operations consist primarily of collecting, sorting and processing various grades of copper, aluminum and brass.

The waste services segment provides waste management services including contract negotiations with service providers, centralized billing, invoice auditing and centralized dispatching. Waste services also rents, leases, sells, and services waste handling and recycling equipment.

Although our focus is on the recycling industry, our goal is to remain dedicated to the waste services industry as well, while sustaining steady growth at an acceptable profit, adding to our net worth, and providing positive returns for our 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.

Available Information

We make available, free of charge, through our website www.isa-inc.com, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, and amendments to those reports as soon as reasonably practicable after we have electronically filed with the Securities and Exchange Commission. We also make available on our website our audit committee charter, our Business Ethics Policy and Code of Conduct and our Code of Ethics for the CEO, CFO and senior financial officers. Please note that our Internet address is included in this annual report on Form 10-K as an inactive textual reference only. Information contained on our website www.isa-inc.com is not incorporated by reference into this annual report on Form 10-K and should not be considered a part of this report.

ISA Recycling Operating Division

Since October 2005, we have focused much of our attention on our recycling business segment. We sell processed ferrous and non-ferrous scrap material, including stainless steel, to end-users such as steel mini-mills, integrated steel makers and 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 sorting, shearing, cutting, shredding and/or baling. We also remain dedicated to initiating growth in our waste management business segment, which includes management services and waste and recycling equipment sales, service and leasing.

Ferrous Operations

Ferrous Scrap Purchasing - We purchase ferrous scrap from two primary sources: (i) industrial and commercial generators of steel and iron; and (ii) scrap dealers, peddlers, and other generators and collectors who sell us steel and iron scrap, known as obsolete scrap. Market demand and the composition, quality, size and weight of the materials are the primary factors that determine prices paid to these material providers.

Ferrous Scrap Processing - We prepare ferrous scrap material for resale through a variety of methods including sorting, shearing, cutting, shredding and baling. We produce a number of differently sized, shaped and graded products depending upon customer specifications and market demand.

Sorting - After purchasing ferrous scrap material, we inspect it to determine how we should process it to maximize profitability. In some instances, we may sort scrap material and sell it without further processing. We separate scrap material for further processing according to its size, composition and grade by using conveyor systems, front-end loaders, crane-mounted electromagnets and claw-like grapples.

Shearing or Cutting - Pieces of oversized ferrous scrap material, such as obsolete steel girders and used pipe, which are too large for other processing are cut with hand torches, crane-mounted alligator shears or stationary guillotine shears.

Shredding We shred large pieces of ferrous scrap material, such as automobiles and major appliances, in our shredder by hammer mill action into pieces of a workable size that pass through magnetic separators to separate metal from synthetic foam, fabric, rubber, stone, dirt, etc. The metal we recover from the shredding process we sell directly to customers or reuse in some other metal blend. The substantially non-metallic residue by-product is usually referred to as automobile shredder residue (ASR) or shredder fluff. We dispose of the non-metal components, which can reduce the volume of the scrap as much as 25.0%, in a landfill. We began using the shredder system July 1, 2009.

Baling - We process light-gauge ferrous materials such as clips, sheet iron and by-products from industrial and commercial processes, such as stampings, clippings and excess trimmings, by baling these materials into large, uniform blocks. We use cranes and conveyors to feed the material into a hydraulic press, which compresses the material into uniform blocks.

Ferrous Scrap Sales - We sell processed ferrous scrap material to end-users such as steel mini-mills, integrated steel makers and foundries, and brokers who aggregate materials for other large users. Most customers purchase processed ferrous scrap material through negotiated spot sales contracts, which establish the quantity purchased for the month and the pricing. The price we charge for ferrous scrap materials depends upon market supply and demand, as well as quality and grade of the scrap material. We deliver all scrap ourselves or using third party carriers via truck, railcar, and/or barge. Some customers choose to send their own delivery trucks. These trucks are weighed and loaded at one of our sites based on the sales order.

Non-Ferrous Operations

Non-Ferrous Scrap Purchasing - We purchase non-ferrous scrap from two primary sources: (i) industrial and commercial non-ferrous scrap material providers who generate or sell waste aluminum, copper, stainless steel, other nickel-bearing metals, brass and other metals; and (ii) peddlers, scrap dealers, generators and collectors who deliver directly to our facilities material that they collect from a variety of sources. We also collect non-ferrous scrap from sources other than those that are delivered directly to our processing facilities by placing retrieval boxes at these sources. We subsequently transport the boxes to our processing facilities.

Non-Ferrous Scrap Processing - We prepare non-ferrous scrap metals, principally aluminum, copper, brass and stainless steel to sell by sorting, shearing, cutting, shredding or baling.

Sorting - Our sorting operations separate and identify non-ferrous scrap by using front-end loaders, grinders, hand torches and spectrometers. Our ability to identify metallurgical composition maximizes margins and profitability. We sort non-ferrous scrap material for further processing according to type, grade, size and chemical composition. Throughout the sorting process, we determine whether the material requires further processing before we sell it.

Shearing or Cutting - Pieces of oversized non-ferrous scrap material, which are too large for other processing methods, are cut with alligator shears.

Shredding We shred large pieces of nonferrous scrap material, such as steel drums, copper and aluminum cable, tubing, sheet metal, extrusions, and baled aluminum, in our shredder by hammer mill action into pieces of a workable size that pass through magnetic separators to separate metal from synthetic foam, fabric, rubber, stone, dirt, etc. The metal we recover from the shredding process we sell directly to customers or reuse in some other metal blend. We dispose of the non-metal components, which can reduce the volume of the scrap as much as 25.0%, in a landfill. We began using the shredder system July 1, 2009.

Baling - We process non-ferrous metals such as aluminum cans, sheet and siding by baling these materials into large uniform blocks. We use front-end loaders and conveyors to feed the material into a hydraulic press, which compresses the material into uniform blocks.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

Non-Ferrous Scrap Sales - We sell processed non-ferrous scrap material to end-users such as foundries, aluminum sheet and ingot manufacturers, copper refineries and smelters, steel mini-mills, integrated steel makers, steel foundries and refineries, and brass and bronze ingot manufacturers. Prices for the majority of non-ferrous scrap materials change based upon the daily publication of spot and futures prices on COMEX or the London Metals Exchange. We deliver all scrap ourselves or using third party carriers via truck, railcar, and/or barge. Some customers choose to send their own delivery trucks. These trucks are weighed and loaded at one of our sites based on the sales order.

Waste Services Operations

Our Waste Services operations are in the business of commercial, retail and industrial waste and recycling management services (operating under the name commercial waste services or CWS) and commercial and industrial waste and recycling handling equipment sales, rental and maintenance (operating under the name waste equipment sales and service company or WESSCO). CWS offers a total package concept to commercial, retail and industrial customers for their waste and recycling management needs. Combining waste reduction and diversion, and waste equipment technology, CWS creates waste and recycling programs tailored to each customer's needs. The services we offer include locating and contracting with a hauling company and recycler at a reasonable cost for each participating location. CWS does not own waste-transporting trucks or landfills. We do not operate or partner with any of the national hauling or recycling companies, and none of these companies own us. We are able to maintain a neutral position for the benefit of our customers. We have designed and developed proprietary computer software that provides our personnel with relevant information on each customer's locations, as well as pertinent information on service providers, disposal rates, costs of equipment, including installation and shipping, disposal rates and recycling prices. This software has allowed us to build a database for serving our customers that have locations nationwide as well as in Canada. This software enables us to generate detailed monthly customized billing reports, and price tracking to accommodate our customers' needs.

Our commercial waste services division provides our customers evaluation, management, monitoring, auditing, cost reduction and containment of non-hazardous solid waste removal and recycling activities. CWS has an active network of 1,049 hauling, landfill, recycling and equipment manufacturing and maintenance service providers throughout the United States and Canada. Through this network, we are able to provide pricing estimates for current and potential customers. CWS customer service representatives have access to this information through the computer software designed and developed to enhance the value offered to our customers. Through this information retrieval system and database, customer service representatives review and audit the accuracy of recent billings for hauling, landfill and recycling rates.

By offering competitively priced waste and recycling handling equipment from a number of different manufacturers, WESSCO is able to tailor equipment packages for individual customer needs. We do not manufacture any equipment, but we do refurbish, recondition and add options when necessary. We sell, rent and repair all types of industrial and commercial waste and recycling handling equipment such as compactors, balers and containers.

Total Package Concept

Our management services division has third party service providers providing timely service for waste removal and recycling services for our customers. Our recycling division purchases ferrous and nonferrous materials, cardboard and paper on a daily basis. The products or services have value to the customer on a standalone basis. These services make up the total package concept.

Company Background

ISA was incorporated in October 1953 in Florida under the name Alson Manufacturing, Inc. From the date of incorporation through January 5, 1975, Alson designed and manufactured various forms of electrical products. In 1979, the Board of Directors and the shareholders of Alson commenced liquidation of all the tangible assets of Alson. On October 27, 1983, Harry Kletter, our Chairman of the Board and Chief Executive Officer, acquired 629,250 shares of ISA Common Stock. The existing directors resigned and five new directors were elected.

On July 1, 1984, we began a solid waste handling and disposal equipment sales organization under the name Waste Equipment Sales and Services Company, which we refer to as WESSCO. On January 1, 1985, we merged with Computerized Waste Systems, Inc., a Massachusetts corporation. CWS was a corporation specializing in offering solid waste management consultations for large multi-location companies involved in the retail, restaurant and industrial sectors. At the time of the merger, CWS was concentrating on large retail chains, but has changed its emphasis to include commercial and industrial customers. This strategy created an additional target market for us. Subsequent to the merger with CWS, we moved the CWS headquarters from Springfield, Massachusetts to Louisville, Kentucky. At the time of the merger, much of the customer base

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

and marketing efforts were concentrated in the Northeast. With the move to Louisville, we began to expand our marketing efforts, which are now nationwide.

On July 1, 1997, we acquired the assets of a non-ferrous scrap metal recycling facility located at 7100 Grade Lane, Louisville, Kentucky, thus expanding our recycling product lines.

In January 1998, we acquired the business of a ferrous scrap and corrugated paper recycling facility located at 7100 Grade Lane, Louisville, Kentucky. This acquisition was the beginning of our ferrous scrap metal, non-ferrous scrap metal and corrugated paper processing segment known as ISA Recycling.

On June 1, 1998, we acquired all of the business, property, rights and assets of a ferrous and non-ferrous scrap metal recycling facility located in North Vernon, Indiana. On July 8, 2002, we acquired a five-acre tract at 1565 East 4th Street, Seymour Indiana. In the fourth quarter of 2002, we moved our metal recycling facilities from North Vernon, Indiana to Seymour, Indiana.

On February 15, 2005 we leased a location in Lexington, Kentucky. We were using this property as a transfer station for ferrous and nonferrous material. There were no processing operations at this facility. We discontinued operations at this location in the first quarter of 2007 and subleased the location to an unaffiliated party. Both the lease and sublease terminated in the first quarter of 2012. We no longer conduct operations at this site and have no further obligations under the expired lease.

During 2007, we added a location in New Albany, Indiana across the Ohio River from Louisville, Kentucky, the site of our headquarters. We use this property as a transfer station for nonferrous material.

During 2007, we entered into an asset purchase agreement for \$1.3 million funded primarily by a note payable to Industrial Logistic Services, LLC, the sole member of which is Brian Donaghy, our president and chief operating officer, whereby we pay \$20.0 thousand per month for 60 months for various assets including tractor trailers, trucks and containers. The note payable reflects a seven percent (7.0%) interest payment on the outstanding balance plus principal amortization. We also paid ILS \$100.0 thousand cash as a portion of the purchase price at the time of execution of the asset purchase agreement.

During 2008, we added a location near our Grade Lane site. We purchased the former Allied System truck terminal at 6709 Grade Lane. The 20,182 square foot facility sits on a 4.4 acre asphalted parking area. ISA Logistics and WESSCO occupy this property, relocated from the main Louisville location, creating room for the new shredder and related maintenance equipment. In September, 2009, we completed the widening of Grade Lane to three lanes along our property, allowing traffic to move more freely and safely. The road improvements accommodate our growth from the \$10.0 million shredder project. The shredder began operations on July, 1, 2009. It shreds ferrous and non ferrous scrap for domestic and international consumers.

In January, 2009, we expanded into the stainless steel and high-temperature alloys recycling business by purchasing inventories from Ventures Metals, LLC for \$9.1 million, agreeing to lease its processing equipment and facilities on Camp Ground Road in Louisville, Kentucky and in Mobile, Alabama, and hiring two executives to head up a new ISA Alloys division, both of whom have since left the Company. On April 2, 2009, we completed the acquisition of the Camp Ground Road property consisting of 5.67 acres plus improvements from Luca Investments, LLC, an affiliate of Venture Metals, for a purchase price of \$2.1 million, comprised of \$1.3 million in cash and 300,000 shares of our common stock, valued at \$2.67 per share on April 2, 2009. On April 13, 2009, we concluded the purchase of the fixed assets of Venture Metals, LLC for \$1.5 million, less the rental we paid at \$15.0 thousand per month from February 11, 2009 through April 2, 2009 for use of the fixed assets.

In March, 2009, we transformed the Camp Ground Road location into a full-service recycling material receiving facility. We use this property as a transfer station for ferrous and nonferrous material. In June 2009, we closed the Mobile, Alabama office.

In September, 2009, we purchased two tracts of real estate on Grade Lane near the current Grade Lane site through the acquisition of all outstanding membership interests in 7124 Grade Lane LLC and 7200 Grade Lane LLC, each a Kentucky limited liability company, owned by Harry Kletter Family Limited Partnership, a Kentucky limited partnership. Mr. Kletter is our chairman and chief executive officer and the general partner of Harry Kletter Family Limited Partnership. One tract (7124 Grade Lane) contains the shredder, and the other tract (7200 Grade Lane) provides a new entrance for the shredder and ISA Alloys. We built new scales on this site, and ISA Alloys uses the space to store inventory. With respect to the purchase of the membership interests in 7200 Grade Lane LLC, we provided to the limited partnership 550,871 shares at \$4.27 per share for a

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

purchase price of \$2.3 million and with respect to the purchase of the membership interests in 7124 Grade Lane LLC, we provided to the limited partnership 199,220 shares at \$4.27 per share for a purchase price of \$850.0 thousand.

In November, 2009, we moved the ISA Alloys division from the Camp Ground Road location to 7100 Grade Lane.

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.

Industry Background

The waste collection and disposal business in the United States is a multi-billion dollar industry. The size of this industry has increased for the past several years and should continue to increase as landfill space decreases. Although society and industry have developed an increased awareness of environmental issues and recycling has increased, waste production also continues to increase. Because of environmental concerns, new regulations and cost factors, it has become difficult to obtain the necessary permits to build any new landfills. We believe we are in a position to represent the best interest of our customers and find competitive pricing for their waste collection and disposal needs.

In addition to increasing landfill costs, regulatory measures and more stringent control of material bound for disposal are making the management of solid waste an increasingly difficult problem. The United States Environmental Protection Agency is expected to continue the present trend of restricting the amount of potentially recyclable material bound for landfills. Many states have passed, or are contemplating, measures that would require industrial and commercial companies to recycle a minimum percentage of their waste stream and restrict the percentage of recyclable materials in any commercial load of waste material. Many states have already passed restrictive regulations requiring a plan for the reduction of waste or the segregation of recyclable materials from the waste stream at the source. ISA management believes that these restrictions may create additional marketing opportunities as waste disposal needs become more specialized. Some large industrial and commercial companies have hired in-house staff to handle the solid waste management and recycling responsibilities, but have found that without adequate resources and staff support, in-house handling of these responsibilities may not be an effective alternative. We offer these establishments a solution to this increasing burden.

Competition

The metal recycling business is highly competitive and is subject to significant changes in economic and market conditions. At the end of 2011, the American economy was showing cautious signs of improvement in consumer confidence, job creation, manufacturing, housing, and the automobile industry. European economies were not as promising. Metal prices, specifically nickel, dropped significantly in the latter half of the year, hitting lows in late November. Pricing and proximity to a metal source are the major competitive factors in the metal recycling business. We compete for the purchase and sale of scrap metal with large, well-financed recyclers of scrap metal as well as smaller metal facilities and brokers/dealers. Although we continue to expand our facilities and increase our processing efficiencies, including the completion of the shredder system in 2009, certain of our competitors have greater financial, marketing and physical resources. There can be no assurance that we will be able to obtain our desired market share based on the competitive nature of this industry.

On a commercial/industrial waste management level, we have competition from a variety of sources. Much of it is from companies that concentrate their efforts on a regional level and two of the major national waste haulers.

We have faced increased competition from national hauling and recycling companies in recent years. The large national hauling and recycling companies often attempt to handle all locations for a national chain customer. This scenario poses a potential conflict of interest since these hauling companies and recyclers can attain greater profitability from increases in hauling and disposal revenues and fluctuations in recycling prices. In addition to having an economic incentive in allowing customers to have more hauls than needed, light loads, and higher hauling and disposal rates, the national hauling companies do not have operations in every community. Therefore, for many cities, hauling companies must obtain bids from local hauling, disposal and recycling companies that may perceive the national haulers to be competitors. We have encountered reluctance from independent hauling and recycling companies to support services in areas not serviced by these national companies. We have positioned ourselves to work with the national and independent haulers and recyclers to efficiently service our customers on a nationwide basis.

Along with positioning ourselves to efficiently service our customers, our management services division methods of competition include offering our clients competitive pricing, superior customer service and industry expertise. We are known for our exemplary service to our clients and timely payments to our vendors. We are able to offer management programs and tailor-made reports for our clients' specific needs.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

There is also competition from some equipment manufacturers and the major waste haulers for management services as well as waste/recycling equipment purchases and rental programs. Prospective customers look for cost justification when procuring management programs and waste or recycling equipment.

Dependence on Major Customer

Sales to North American Stainless, our largest customer, represented approximately 44.4% and 63.8% of our net sales for the years ended December 31, 2011 and 2010, respectively. Our cash flow experiences a significant decline between the time we acquire scrap metal for processing and the time we receive payment for these goods. The loss of North American Stainless as a customer would negatively impact our revenues and profitability and could materially and adversely affect our results of operations and financial condition.

Employees

As of December 31, 2011, we had one hundred seventy-six (176) full-time employees as follows: recycling 93, management services 8, sales/leasing 4, drivers 19, maintenance 17, and administration/information technology 35. None of our employees are a member of a union.

Effect of State and Federal Environmental Regulations

Any environmental regulatory liability relating to our operations is generally borne by the customers with whom we contract and the service providers in their capacity as transporters, disposers and recyclers. Our policy is to use our best efforts to secure indemnification for environmental liability from our customers and service providers. Although we believe that our business model adequately protects us from potential environmental liability, we also continue to use our best efforts to be in compliance with federal, state and local environmental laws, including but not limited to the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, the Hazardous Materials Transportation Act, as amended, the Resource Conservation and Recovery Act, as amended, the Clean Air Act, as amended, and the Clean Water Act. Such compliance has not historically constituted a material expense to us.

The collection and disposal of solid waste and rendering of related environmental services as well as recycling operations and issues are subject to federal, state and local requirements, which regulate health, safety, the environment, zoning and land-use. Federal, state and local regulations vary, but generally govern hauling, disposal and recycling activities and the location and use of facilities and also impose restrictions to prohibit or minimize air and water pollution. In addition, governmental authorities have the power to enforce compliance with these regulations and to obtain injunctions or impose fines in the case of violations, including criminal penalties. The EPA and various other federal, state and local environmental, health and safety agencies and authorities, including the Occupational Safety and Health Administration of the U.S. Department of Labor administer those regulations.

We strive to conduct our operations in compliance with applicable laws and regulations. While such amounts expended in the past or that we anticipate spending in the future have not had and are not expected to have a material adverse effect on our financial condition or operations, the possibility remains that technological, regulatory or enforcement developments, the results of environmental studies or other factors could materially alter this expectation.

Each state in which we operate has its own laws and regulations governing solid waste disposal, water and air pollution and, in most cases, releases and cleanup of hazardous substances and liability for such matters. Several states have enacted laws that will require counties to adopt comprehensive plans to reduce, through waste planning, composting, recycling, or other programs, and the volume of solid waste landfills. Several states have recently enacted these laws. Legislative and regulatory measures to mandate or encourage waste reduction at the source and waste recycling also are under consideration by Congress and the EPA.

Finally, various states have enacted, or are considering enacting, laws that restrict the disposal within the state of solid or hazardous wastes generated outside the state. While courts have declared unconstitutional laws that overtly discriminate against out of state waste, courts have upheld some laws that are less overtly discriminatory. Challenges to other such laws are pending. The outcome of pending litigation and the likelihood that jurisdictions will adopt other such laws that will survive constitutional challenge are uncertain.

ITEM 1A. RISK FACTORS

Risk Factors

This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, including, in particular, certain statements about our plans, strategies and prospects. Although we believe that our plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, we cannot assure you that such plans, intentions or expectations will be achieved. Important factors that could cause our actual results to differ materially from our forward-looking statements include those set forth in this Risk Factors section. All forward-looking statements attributable to us or any persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth below. Unless the context requires otherwise, all references to the company, we, us or our include Industrial Services of America, Inc. and subsidiaries.

If any of the following risks, or other risks not presently known to us or that we currently believe to not be significant, develop into actual events, then our business, financial condition, results of operations, cash flows or prospects could be materially adversely affected.

Risks Related to Our Operations

Our business has increasing involvement in stainless steel, ferrous, non-ferrous and fiber recycling. Changes in prices, demand, including foreign demand, regulation, economic slowdowns or increased competition could result in a reduction of our revenue and consequent decrease in our common stock price.

The metal recycling business is highly competitive and is subject to significant changes in economic and market conditions. At the end of 2011, the American economy was showing cautious signs of improvement in consumer confidence, job creation, manufacturing, housing, and the automobile industry. European economies were not as promising. Metal prices, specifically nickel, dropped significantly in the latter half of the year, hitting lows in late November. Pricing and proximity to a metal source are the major competitive factors in the metal recycling business. Many companies offer or are engaged in the development of products or the provisions of services that may be or are competitive with our current products or services. Although we continue to expand our facilities and increase our processing efficiencies, including the completion of the shredder system in 2009, certain of our competitors have greater financial, technical, manufacturing, marketing, distribution, assets, and other resources than we possess in the stainless steel, ferrous, non-ferrous and fiber recycling businesses. In addition, the industry is constantly changing as a result of consolidation that may create additional competitive pressures in our business environment. There can be no assurance that we will be able to obtain our desired market share based on the competitive nature of this industry.

Volatility in market prices of our scrap metal recycling inventory may adversely affect our business.

We make certain assumptions regarding future demand and net realizable value in order to assess that we record our stainless steel, ferrous, non-ferrous and fiber recycling inventory properly at the lower of cost or market. We base our assumptions on historical experience, current market conditions and current replacement costs. If the anticipated future selling prices of scrap metal and finished steel products should decline due to the cyclical nature of the business or otherwise, we would re-assess the recorded net realizable value of such inventory and make any adjustments we feel necessary in order to reduce the value of such inventory (and increase cost of goods sold) to the lower of cost or market.

An increase in the price of fuel may adversely affect our business.

Our operations are dependent upon fuel, which we generally purchase in the open market on a daily basis. Direct fuel costs include the cost of fuel and other petroleum-based products used to operate our shredder, fleet of cranes and heavy equipment. We are also susceptible to increases in indirect fuel costs which include fuel surcharges from vendors. During 2007 and 2008, we experienced increases in the cost of fuel and other petroleum-based products, although these prices decreased in later 2008 and 2009. A portion of these increases we passed on to our customers. However, because of the competitive nature of the industry, there can be no assurance that we will be able to pass on current or future increases in fuel prices to our customers. Fuel costs increased in 2011 compared to 2010, and predictions are mixed for 2012. Due to geopolitical events, fuel prices have remained elevated and may increase again throughout 2012. A significant increase in fuel costs could adversely affect our business.

We could incur substantial costs in order to comply with, or to address any violations under, environmental laws that could significantly increase our operating expenses and reduce our operating income.

Our operations are subject to various environmental statutes and regulations, including laws and regulations addressing materials used in the processing of our products. In addition, certain of our operations are subject to federal, state and local environmental laws and regulations that impose limitations on the discharge of pollutants into the air and water and establish standards for the treatment, storage and disposal of solid and hazardous wastes. Failure to maintain or achieve compliance with these laws and regulations or with the permits required for our operations could result in substantial operating costs and capital expenditures, in addition to fines and civil or criminal sanctions, third party claims for property damage or personal injury, cleanup costs or temporary or permanent discontinuance of operations. Certain of our facilities have been in operation for many years and, over time, we and other predecessor operators of these facilities have generated, used, handled and disposed of hazardous and other regulated wastes. Environmental liabilities could exist, including cleanup obligations at these facilities or at off-site locations where we disposed of materials from our operations, which could result in future expenditures that we cannot currently quantify and which could reduce our profits.

Our financial statements are based upon estimates and assumptions that may differ from actual results.

We have prepared our financial statements in accordance with U.S. generally accepted accounting principles and necessarily include amounts based on estimates and assumptions we made. Actual results could differ from these amounts. Significant items subject to such estimates and assumptions include the carrying value of long-lived assets, valuation allowances for accounts receivable, lower of cost or market, liabilities for potential litigation, claims and assessments, and liabilities for environmental remediation and deferred taxes.

We depend on our senior management team and the loss of any member could prevent us from implementing our business strategy.

Our success is dependent on the management and leadership skills of our senior management team. We have entered into employment agreements with three of our executives. The loss of any members of our management team or the failure to attract and retain additional qualified personnel could prevent us from implementing our business strategy and continuing to grow our business at a rate necessary to maintain future profitability.

The concentration of our customers could have a material adverse effect on our results of operations and financial condition.

Sales to North American Stainless, our largest customer, represented approximately 44.4% and 63.8% of our net sales for the years ended December 31, 2011 and 2010, respectively. Our cash flow experiences a significant decline between the time we acquire scrap metal for processing and the time we receive payment for these goods. The loss of this or other significant customers or our inability to collect accounts receivable would negatively impact our revenues and profitability and could materially and adversely affect our results of operations and financial condition.

Our exposure to credit risk could have a material adverse effect on our results of operations and financial condition.

Our business is subject to the risks of nonpayment and nonperformance by our customers. Downturns in the economy in 2008 led to bankruptcy filings by many of our customers, which caused us to recognize additional allowances for doubtful accounts receivable in previous years. While we believe our allowance for doubtful accounts is adequate, changes in economic conditions or any weakness in the steel and metals industries could cause potential credit losses from our significant customers, which could adversely impact our future earnings or financial condition.

Our debt may increase our vulnerability to economic or business downturns.

We are vulnerable to higher interest rates because interest expense on certain of our borrowings is based on margins over a variable base rate. We may experience material increases in our interest expense as a result of increases in general interest rate levels. If we were to breach covenants in our lending facilities, our lenders could exercise their remedies related to any material breaches, including acceleration of our payments and taking action with respect to their loan security. For the year ending December 31, 2011, we were not in compliance with two of our debt covenants. We received a waiver from the bank for failing to meet these requirements as of December 31, 2011. We cannot ensure that the bank would provide additional waivers if we are not in compliance with our debt covenants in the future.

From time to time, we have relied upon and will rely on borrowings under various credit facilities and from other lenders to operate our business. However, the recent financial crisis has adversely affected many financial institutions and, as a result,

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

such financial institutions have ceased or reduced the amount of lending they have made available to their customers. As a result, we may not have the ability to borrow from other lenders to operate our business.

Seasonal changes may adversely affect our business and operations.

Our operations may be adversely affected by periods of inclement weather, which could decrease the collection and shipment volume of recycling materials.

Risks Related to Our Common Stock

Future sales of our common stock could depress our market price and diminish the value of your investment.

Future sales of shares of our common stock could adversely affect the prevailing market price of our common stock. If our existing shareholders sell a large number of shares, or if we issue a large number of shares, the market price of our common stock could significantly decline. Moreover, the perception in the public market that our existing shareholders and in particular members of the Kletter family might sell shares of common stock could depress the market for our common stock.

The market price for our common stock may be volatile.

In recent periods, there has been volatility in the market price for our common stock. In addition, the market price of our common stock could fluctuate substantially in the future in response to a number of factors, including the following:

- Our quarterly operating results or the operating results of our companies in the waste management or ferrous, non-ferrous and fiber recycling industry;
- Changes in general conditions in the economy, the financial markets or the ferrous, non-ferrous and fiber recycling industry;
- Loss of significant customers and
- Increases in materials and other costs.

In addition, in recent years the stock market has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market prices of securities issued by many companies for reasons unrelated to their operating performance. These broad market fluctuations may materially adversely affect our stock price, regardless of our operating results.

Item 2. Properties.

The following table outlines our principle properties:

| Property Address | Lease or own | Segment | Acreage |
|---|-----------------|--|---------|
| 6709 Grade Lane, Louisville, KY | Own | Recycling | 4.491 |
| 7021-7103 Grade Lane, Louisville, KY | Own | Recycling | 2.530 |
| 7020/7100 Grade Lane, Louisville, KY | Lease (K&R) (1) | Recycling, Waste Services, and Other | 14.23 |
| 7110 Grade Lane, Louisville, KY | Own | Recycling | 10.723 |
| 7124 Grade Lane, Louisville, KY | Own | Recycling | 5.120 |
| 7017 Grade Lane, Louisville, KY | Own | Recycling | 1.501 |
| 7200-7210 Grade Lane, Louisville, KY | Own | Recycling | 15.52 |
| 3409 Camp Ground Road, Louisville, KY | Own | Recycling | 5.670 |
| 1565 E. 4 th Street, Seymour, IN | Own | Recycling | 5.003 |
| 1617 State Road 111, New Albany, IN | Own | Recycling | 1.300 |

- (1) On February 16, 1998 our Board of Directors ratified and formalized an existing relationship in connection with our leasing of facilities from K&R, LLC. K&R is our affiliate because our Chief Executive Officer and principal shareholder, Harry Kletter, owns 100.0% of K&R. The rent beginning January 1, 2008 became \$582.0 thousand per annum, payable at the beginning of each month in an amount equal to \$48.5 thousand. This fixed minimum rent adjusts each five years, including for each of the option periods, in accordance with the consumer price index. The

fixed minimum rent also increases to \$750.0 thousand per annum, in an amount equal to \$62.5 thousand per month in the event of our change in control. We must pay, as additional rent, all real estate taxes, insurance, utilities, maintenance and repairs, replacements (including replacement of roofs if necessary) and other expenses. Under the lease, we must also cover any damages arising out of our use of the leased property, unless such damages are caused by K&R's negligence. In an addendum to the K&R lease as of January 1, 2005, the rent was increased \$4.0 thousand as a result of the improvements made to the property in 2004. For years 2005 through 2011, the payments to K&R by the Company of \$4.0 thousand for additional rent and the monthly payment from K&R to the Company of \$3.9 thousand for a promissory note were offset.

These properties total 66.088 acres, which provides adequate space necessary to perform administrative and retail operation processes and store inventory. All facilities are well-maintained and insured. We do not expect any major land or building additions will be needed to increase capacity for our operations in the foreseeable future.

Lease and Sublease Agreements - Lexington

We subleased the Lexington property to an unaffiliated party for a term that commenced March 1, 2007 and ended January 31, 2012 for \$4.5 thousand per month. We leased this property from an unrelated party for \$4.5 thousand per month; the lease terminated February 10, 2012.

Property Purchase - Camp Ground Road, Louisville, Kentucky

On January 13, 2009, we entered into an inventory purchase agreement with Venture Metals, LLC, one of the terms of which provided us with the right to retain the use of the property located at 3409 Camp Ground Road, Louisville, Kentucky, for a period not to exceed two years for a monthly rental of \$15.0 thousand. The property consists of 5.67 acres with a 7,875 square foot building. In March 2009, we transformed the Camp Ground Road location into a full-service recycling material receiving facility. We purchased this property on April 2, 2009.

Property Purchase - Grade Lane, Louisville, Kentucky

On September 10, 2009 we completed the acquisition of all outstanding membership interests in 7124 Grade Lane LLC and 7200 Grade Lane LLC, each a Kentucky limited liability company, owned by Harry Kletter Family Limited Partnership, a Kentucky limited partnership. Mr. Kletter is our chairman and chief executive officer and the general partner of Harry Kletter Family Limited Partnership.

7124 Grade Lane LLC and 7200 Grade Lane LLC own properties at 7124 Grade Lane and 7200 Grade Lane, Louisville, Kentucky, respectively. Prior to the consummation of the acquisition of the interests in the limited liability companies on September 10, 2009, Harry Kletter Family Limited Partnership owned all the membership interests in each of 7124 Grade Lane LLC and 7200 Grade Lane LLC. We acquired these membership interests, and in effect the properties, due to their strategic location adjacent to 7100 Grade Lane, Louisville, Kentucky where we have our principal operations and headquarters and recently completed the construction of a new shredder system and part of the installation rests on the property.

The transaction received approval of our audit committee, a disinterested majority of our board of directors, and a majority of the outstanding shares of our common stock by written consent, excluding the shares owned by Mr. Kletter.

Item 3. Legal Proceedings.

On January 4, 2007, Lennox Industries, Inc., a commercial heating and air-conditioning manufacturer, filed a suit against us captioned Lennox Industries, Inc. v. Industrial Services of America, Inc., Case No. CV-2007-004, in the Arkansas County, Arkansas Circuit Court in Stuttgart, Arkansas. Lennox in its Second Amended Complaint alleged breach of contract, negligence, and breach of fiduciary duty arising from our 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 termination on November 17, 2005. Both compensatory and punitive damages were sought by Lennox.

A jury trial was held from June 20-24, 2011. The punitive damage claim was withdrawn by Lennox at the conclusion of its case, and Lennox claimed over \$1.0 million in compensatory damages. On June 24, the jury found in ISA's favor on five of the six claims. Lennox was awarded \$175.0 thousand on the remaining claim.

Following the trial, both Lennox and ISA filed motions with the court seeking an award of attorney fees against each other. Lennox also filed a motion requesting an award of pre-judgment interest on the \$175.0 thousand verdict. The Court denied both of Lennox's motions and granted ISA's motion for attorney fees in the amount of \$98.0 thousand against Lennox.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

No appeal was taken by either party, and a Mutual General Release was signed as part of a final negotiated settlement in which Lennox received \$84.5 thousand. A Satisfaction of Judgment was filed with the court on December 28, 2011, and the case is closed.

We have litigation from time to time, including employment-related claims, none of which we currently believe to be material.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for ISA's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Effective August 29, 1996, the \$0.0033 par value ISA common stock became listed on the Small Cap Market (the Small Cap Market) of the NASDAQ Stock Market under the symbol IDSA. On May 3, 2010, the Board of Directors declared a 3-for-2 stock split effected by a 50% stock dividend. The stock dividend was issued to holders of record as of May 17, 2010, and paid June 1, 2010. All share numbers and prices in this Form 10-K have been adjusted to reflect the impact of this stock split. High and low sales price of the common stock price is summarized as follows:

| Quarter Ended | 2011 | | 2010 | | 2009 | |
|---------------|----------|---------|----------|----------|---------|---------|
| | High | Low | High | Low | High | Low |
| March 31 | \$ 14.48 | \$ 9.83 | \$ 11.93 | \$ 6.20 | \$ 5.19 | \$ 2.40 |
| June 30 | \$ 13.02 | \$ 9.26 | \$ 15.27 | \$ 9.23 | \$ 4.77 | \$ 2.47 |
| September 30 | \$ 11.30 | \$ 5.55 | \$ 21.18 | \$ 10.00 | \$ 6.02 | \$ 4.04 |
| December 31 | \$ 6.77 | \$ 4.03 | \$ 16.55 | \$ 9.61 | \$ 7.89 | \$ 5.47 |

There were approximately 170 shareholders of record as of December 31, 2011.

Our Board of Directors did not declare any dividends in 2010 or 2011.

Under our loan agreement with Fifth Third Bank, ISA may make restricted payments constituting dividends if, and to the extent, that each of the following conditions has been met (i) our Board of Directors has approved them; (ii) such restricted payments made in any fiscal year do not exceed \$750.0 thousand; (iii) if, after giving effect to such restricted payments, revolving loan availability is equal to or greater than an aggregate amount equal to \$1.0 million; (iv) after giving effect to the proposed restricted payments, no default or event of default has occurred and is continuing as of the date such restricted payment occurs, and (v) ISA is in compliance with the financial covenants on a pro forma basis, after giving effect to such restricted payment.

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. We did not repurchase any shares in 2011 or 2010.

Unregistered sales of equity securities and use of proceeds

The following sales of unregistered securities occurred during the fiscal years ended December 31, 2011 and 2010:

On July 1, 2010, we issued 300,000 shares of our common stock to Venture Metals, LLC (Venture), a company owned by Messers. Jones and Valentine, employees at the time of the transaction, in exchange for the 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. In the agreement relating to the purchase of the Venture customer list, the Venture name, and the non-compete agreements, we agreed to issue additional shares to Messers. Jones and Valentine if the Venture division of our business achieved certain specified targets in fiscal year 2010. Because we met these targets, we issued another 90,000 shares of our common stock to Messers. Jones and Valentine on February 24, 2011. The issuances of shares to Venture and Messers. Jones and Valentine were exempt under Section 4(2) of the Securities Act of 1933, as amended, because they: (1) did not involve a public offering and were made without general solicitation or advertising; and (2) Venture previously represented to us that it is an accredited investor, and that the securities were acquired for investment purposes only and not with a view to, or for resale in connection with, any distribution thereof.

Item 6. Selected Financial Data.
Selected Financial Data

(Amounts in thousands, except per share data)

| Year ended December 31: | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|-------------|-------------|-------------|-------------|-------------|
| Total revenue | \$ 276,870 | \$ 343,005 | \$ 181,052 | \$ 100,042 | \$ 76,956 |
| Net (loss) income | \$ (3,881) | \$ 8,053 | \$ 5,285 | \$ 1,528 | \$ 2,564 |
| Earnings (loss) per common share: | | | | | |
| Basic | \$ (0.56) | \$ 1.22 | \$ 0.91 | \$ 0.28 | \$ 0.47 |
| Diluted | \$ (0.56) | \$ 1.21 | \$ 0.91 | \$ 0.28 | \$ 0.47 |
| Cash dividends declared per common share | \$ | \$ | \$ | \$ 0.0667 | \$ 0.0667 |
| At year end: | | | | | |
| Total assets | \$ 80,970 | \$ 106,162 | \$ 66,674 | \$ 28,791 | \$ 26,285 |
| Long term debt and capital lease obligations, net of current maturities | \$ 26,688 | \$ 43,623 | \$ 16,654 | \$ 8,531 | \$ 8,495 |

In 2009, ISA expanded into the stainless steel and high-temperature alloys recycling business by acquiring certain operating assets and hiring key employees. ISA also began our shredder operations in mid-2009. These events increased our revenues by expanding our sales and improving our product efficiencies. In 2011, the price of nickel, the key metal in stainless steel blends, decreased in the second quarter, reaching its low in November. Demand for stainless steel also decreased. In response to these conditions, we made an adjustment of \$3.4 million in the third quarter to lower our inventory value to lower of cost or market. These events negatively affected our sales and net income in 2011.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

The following discussion and analysis should be read in conjunction with the information set forth under Item 6, Selected Financial Data and our 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. Please see Item 1A, Risk Factors for items that could affect our financial predictions, forecasts and projections.

General

We are primarily focusing our attention now and in the future towards our recycling business segment. 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 sorting, shearing, shredding, 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.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

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

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

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 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 900 customer locations throughout the United States and Canada and we utilize an active database of over 7,000 vendors to provide timely, thorough and cost-effective service to our customers.

Although our focus is principally on the recycling industry, our goal is to remain dedicated to the recycling, 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, and Seymour and New Albany, Indiana. We do not have operating locations outside the United States.

Liquidity and Capital Resources

As of December 31, 2011, we held cash and cash equivalents of \$2.3 million. We maintain a cash account on deposit with BB&T which serves as collateral for our swap agreements. As of December 31, 2011, the balance in this account was \$653.1 thousand. Other than this balance, our cash accounts are available to us without restriction.

On March 2, 2012, Industrial Services of America, Inc. and ISA Indiana, Inc. (the Companies) entered into a Third Amendment to Credit Agreement (the Third Amendment) with Fifth Third Bank (the Bank) which amended the July 30, 2010 Credit Agreement (the Credit Agreement), including the First Amendment to Credit Agreement dated as of April 14, 2011 (the April Amendment) and the Second Amendment to Credit Agreement dated as of November 16, 2011 (the November Amendment), as follows. The Third Amendment redefines the calculation period for the purpose of measuring compliance with our covenants to maintain a ratio of debt to adjusted EBITDA (the Senior Leverage Ratio) and a ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled payment of principal of not more than 1.20 to 1 (the Fixed Charge Coverage Ratio) such that each ratio will be calculated quarterly for the period beginning January 1, 2012 through the end of each quarter of 2012. Prior to the Third Amendment, the ratios were calculated on a rolling 12 month basis. The Third Amendment also changed the Senior Leverage Ratio from 3.5 to 1 in the original Credit Agreement to (i) 4.25 to 1 in the first quarter of 2012, (ii) 3.50 to 1 in the second and third quarter of 2012, and (iii) 3.25 to 1 in the fourth quarter of 2012 and thereafter. The Third Amendment also increased the unused line fee by 0.25% to 0.75% and provided a waiver of the Senior Leverage Ratio and Fixed Charge Coverage Ratio covenant defaults for the quarter ending December 31, 2011, as discussed below. In addition, the Companies also agreed to perform other customary commitments and pay a fee of \$10.0 thousand to the Bank.

On April 14, 2011, we entered into the April Amendment with the Bank which amends the Credit Agreement between the Company and the Bank as follows: The April Amendment (i) increased the maximum revolving commitment and the maximum amount of eligible inventory advances in the calculation of the borrowing base, (ii) changed the due date of the first excess cash flow payment to April 30, 2012, and (iii) amended certain other provisions of the Credit Agreement and certain of the other loan documents.

On December 6, 2011, we entered into the November Amendment with the Bank which amends the Credit Agreement, as amended by the April Amendment described above. Under the April Amendment, the Company was permitted to borrow the lesser of \$45.0 million (the Maximum Revolving Commitment) or the borrowing base, consisting of the sum of 85% of eligible accounts plus 60% of eligible inventory up to \$18.0 million. Under the November Amendment, the Maximum Revolving Commitment was reduced to \$40.0 million. In addition, the Company agreed to perform other customary commitments.

Under the original Credit Agreement, we were permitted to borrow via a revolving credit facility the lesser of \$40.0 million or the borrowing base, consisting of the sum of 85% of eligible accounts plus 60% of eligible inventory up to \$17.0 million. 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 the 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 an \$8.8 million term loan, entered into to replace several notes payable with another bank. Proceeds of the original revolving credit facility in the amount of \$33.4 million were used to repay the outstanding principal balance of the prior obligations with another bank. 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.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

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. As of December 31, 2011, the interest rate was 3.125%. We also paid a fee of 0.50% on the unused portion. The revolving credit facility expires on July 31, 2013. As of December 31, 2011, the outstanding balance on the revolving line of credit was \$20.1 million.

The \$8.8 million 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 \$105.0 thousand. The first such payment commenced September 1, 2010 and the final payment of the then-unpaid balance becomes due and payable in full on July 31, 2013. In addition, beginning April 30, 2012 (or, if earlier, upon completion of the Company's financial statements for the fiscal year ending December 31, 2011), 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 the Bank a first priority security interest in all equipment other than the rental fleet that we own. As of December 31, 2011, the outstanding balance on the term loan was \$7.0 million.

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 the Bank.

In our Credit Agreement with the Bank, 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 \$4.0 million in any fiscal year. As of December 31, 2011, we were not in compliance with the covenants set forth under (i) and (ii) above. As of December 31, 2011, our ratio of debt to adjusted EBITDA was 9.31; our ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled principal payments was (0.70), and our capital expenditures totaled \$2.5 million, which includes \$36.6 thousand in deposits on equipment. In connection with the Third Amendment, we received a waiver from the Bank for failing to meet the covenants as of December 31, 2011. The Third Amendment also provides that the Senior Leverage Ratio will increase to 4.25 to 1 for the period ending March 31, 2012. The Senior Leverage Ratio will then decrease to 3.5 to 1 for the periods ending June 30 and September 30, 2012 and decrease to 3.25 to 1 for the period ending December 31, 2012 and thereafter. The other covenants will remain the same going forward. As of December 31, 2011, we have \$19.9 million under our existing credit facilities that we can use based on the bank waiver received.

On April 12, 2011, we entered into a Loan and Security Agreement with Fifth Third Bank (the Bank) pursuant to which the Bank agreed to provide the Company with a Promissory Note (the Note) in the amount of \$226.9 thousand for the purpose of purchasing operating equipment. The interest rate is five and 68/100 percent (5.68%). Principal and interest is payable in 48 equal monthly installments of \$5.3 thousand, each due on the 20th day of each calendar month. Payments commenced on the 20th day of May, 2011, and the entire unpaid principal amount hereof, together with all accrued and unpaid interest, charges, fees or other advances, if any, come due on or before April 20, 2015. As security for the Note, we have granted the Bank a first priority security interest in the equipment purchased with the proceeds of the Note. As of December 31, 2011, the outstanding balance of this loan was \$187.1 thousand.

On August 9, 2011, we entered into a Loan and Security Agreement (the August Agreement) with the Bank pursuant to which the Bank agreed to loan the Company funds pursuant to a Promissory Note (the August Note) in the amount of \$115.0 thousand for the purpose of purchasing operating equipment. The interest rate is 5.95%. Principal and interest is payable in 48 equal monthly installments of \$2.7 thousand. The first such payment commenced on September 12, 2011, and the entire unpaid principal amount, together with all accrued and unpaid interest, charges, fees or other advances, if any, becomes due no later than August 12, 2015. As security for the August Note, we have granted the Bank a first priority security interest in the equipment purchased with the proceeds of the Note. As of December 31, 2011, the outstanding balance of this loan was \$106.4 thousand.

On October 19, 2010, we entered into a Promissory Note (the October Note) with the Bank in the amount of \$1.3 million for the purpose of purchasing equipment. The interest rate is equal to five and 20/100 percent (5.20%) per annum. Principal and interest is payable monthly in consecutive equal installments of \$30.5 thousand 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 October Note, we provided Fifth Third Bank a first priority security interest in the equipment purchased with the proceeds. As of December 31, 2011, the outstanding balance on the Note was \$962.4 thousand.

On August 2, 2007, we entered into an asset purchase agreement for \$1.3 million funded primarily by a note payable to ILS, the sole member of which is Brian Donaghy, our president and chief operating officer, whereby we pay \$20.0 thousand per month for 60 months for various assets including tractor trailers, trucks and containers. The note payable reflects a seven percent (7.0%) interest payment on the outstanding balance plus principal amortization. We also paid ILS \$100.0 thousand cash as a portion of the purchase price at the time of

execution of the asset purchase agreement. We recorded a note payable of \$1.0 million with an outstanding balance at December 31, 2011 of \$155.9 thousand.

During 2011, we paid \$2.5 million for improvements, property and equipment. We paid \$692.0 thousand for land, road, and building improvements. In the recycling segment we paid \$1.0 million for cranes, balers, scales, trucks, containers, and other operating equipment and repairs. In the equipment sales, leasing and service segment, we purchased \$340.8 thousand in

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

rental equipment that we located at customer sites. This rental fleet equipment consists of solid waste handling and recycling equipment such as compactors, waste edge monitors, balers, and carts. It is our intention to continue to pursue this market. We purchased \$167.7 thousand in office furniture, equipment, and software, and we purchased and upgraded vehicles for \$251.8 thousand. We paid deposits of \$36.6 thousand on machinery and equipment.

We expect that existing cash flow from operations and available credit under our existing credit facilities will be sufficient to meet our cash needs for the next year and beyond, assuming compliance with the covenants in our Credit Agreement or continued waivers thereof. See Financial condition at December 31, 2011 compared to December 31, 2010 section for additional discussion and details relating to cash flow from operating, investing, and financing activities. We do not have any material capital expenditure commitments as of December 31, 2011.

Critical Accounting Policies

In preparing financial statements in conformity with accounting principles generally accepted in the United States, we make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. We believe that we consistently apply judgments and estimates and that such consistent application results in financial statements and accompanying notes that fairly represent all periods presented. However, any errors in these judgments and estimates may have a material impact on our statement of operations and financial condition. Critical accounting policies, as defined by the Securities and Exchange Commission, are those that are most important to the portrayal of our financial condition and results of operations and require our most difficult and subjective judgments and estimates of matters that are inherently uncertain.

Estimates

In preparing the consolidated financial statements in conformity with generally accepted accounting principles in the United States of America, 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. Examples of estimates include the allowance for doubtful accounts, estimates associated with annual goodwill impairment tests, and estimates of deferred income tax and liabilities. The Company also uses estimates when assessing fair values of assets and liabilities acquired in business acquisitions as well as any fair value and any related impairment charges related to the carrying value of machinery and equipment, and other long-lived assets. Despite the Company's intention to establish accurate estimates and use reasonable assumptions, actual results may differ from these estimates.

Revenue recognition

We recognize revenues from processed ferrous and non-ferrous scrap metal sales when title passes to the customer, which generally is upon delivery of the related materials. We recognize revenues from services as the service is performed. We accrue sales adjustments related to price and weight differences and allowances for uncollectible receivables against revenues as incurred.

Fair Value of Financial Instruments

We estimate the fair value of our financial instruments using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, prepayments and other factors. Changes in assumptions or market conditions could significantly affect these estimates. As of December 31, 2011, the estimated fair value of our financial instruments approximated book value. The fair value of our debt approximates its carrying value because the majority of our debt bears a floating rate of interest based on the LIBOR rate. There is no readily available market by which to determine fair market value of our fixed term debt; however, based on existing interest rates and prevailing rates as of each year end, we have determined that the fair value of our fixed rate debt approximates book 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 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 applicable accounting standards, we categorize our financial assets and liabilities into the following fair value hierarchy:

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

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 financial instruments, in thousands, at December 31, 2011 and December 31, 2010:

| 2011: | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|---------------------------|----------------|----------------|----------------|--------------|
| Assets: | | | | |
| Cash and cash equivalents | \$ 2,267 | \$ | \$ | \$ 2,267 |
| Goodwill | | | 6,840 | 6,840 |
| Net intangible assets | | | 5,025 | 5,025 |
| Liabilities | | | | |
| Long term debt | \$ | \$ (28,509) | \$ | \$ (28,509) |
| Derivative contract | | (484) | | (484) |
| 2010: | | | | |
| Assets: | | | | |
| Cash and cash equivalents | \$ 2,468 | \$ | \$ | \$ 2,468 |
| Goodwill | | | 6,840 | 6,840 |
| Net intangible assets | | | 5,775 | 5,775 |
| Liabilities | | | | |
| Long term debt | \$ | \$ (45,447) | \$ | \$ (45,447) |
| Derivative contract | | (650) | | (650) |

We have had no transfers in or out of Levels 1 or 2 fair value measurements. Other than standard amortization of intangible assets, we have had no activity in Level 3 fair value measurements for the year ending December 31, 2011. For Level 3 assets, goodwill of \$6.8 million is subject to impairment analysis each year end under Phase I of the ASC guidance. No impairment was recorded as of December 31, 2011, as determined by a third party evaluation. See also Note 13 Purchase of Inventory, Fixed Assets, and Intangible Assets of Venture Metals, LLC for additional information on the third party valuation.

Accounts receivable and allowance for doubtful accounts receivable

Accounts receivable consist primarily of amounts due from customers from product and brokered sales. The allowance for doubtful accounts receivable totaled \$100.0 thousand at December 31, 2011 and December 31, 2010. Our determination of the allowance for doubtful accounts receivable includes a number of factors, including the age of the balance, past experience with the customer account, changes in collection patterns and general industry conditions and overall economic conditions impacting industry and customers.

Potential credit losses from our significant customers could adversely affect our results of operations or financial condition. General weakness in the steel and metals sectors in the past led to bankruptcy filings by many of our customers, which caused us to recognize additional allowances for doubtful accounts receivable. While we believe our allowance for doubtful accounts is adequate, changes in economic conditions or any weakness in the steel and metals industries could adversely impact our future earnings.

Inventory

Our inventories primarily consist of stainless steel, ferrous and non-ferrous scrap metals that we value at the lower of average purchased cost or market. We also carry replacement parts in inventory, which we depreciate over a one-year life as these parts are used within a one-year period due to the high-volume and intensity of the shredder process. We determine quantities of inventories based on our inventory systems, which are subject to periodic physical verification using estimation techniques including observation, weighing and other industry methods. Prices of commodities we own may be volatile. We are exposed to risks associated with fluctuations in the market price for both ferrous and non-ferrous metals, which are at times volatile. We attempt to mitigate this risk by seeking to rapidly turn our inventories.

We make certain assumptions regarding future demand and net realizable value in order to assess that inventory is properly recorded at the lower of cost or market. We base our assumptions on historical experience, current market conditions and current replacement costs. If the anticipated future selling prices of scrap metal and finished steel products should decline, we would re-assess the recorded net realizable value of our inventory and make any adjustments we feel necessary in order to reduce the value of our inventory (and increase cost of goods sold) to the lower of cost or market.

As of January 4, 2010, we began using the specific identification method of valuing inventory. See *Inventories* under Note 1 *Summary of Significant Accounting Policies* in the Notes to Consolidated Financial Statements for additional details on this change.

Property and Equipment

We carry the value of land on our books at cost. We report premises and equipment at cost less accumulated depreciation and amortization. We charge depreciation and amortization for financial reporting purposes to operating expense using the straight-line method over the estimated useful lives of the assets. We depreciate some assets over a one year period. Estimated useful lives are up to 40 years for buildings and leasehold improvements, 1 to 10 years for office and operating equipment, and 5 years for rental equipment. Our determination of estimated useful life includes past experience and normal deterioration. We include maintenance and repairs in selling, general and administrative expenses. We include gains and losses on disposition of premises and equipment in gain (loss) on sale of assets.

Valuation of long-lived assets and goodwill

We regularly review the carrying value of certain long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be realizable. If an evaluation is required, we compare the estimated future undiscounted cash flows associated with the asset to the asset's carrying amount to determine if an impairment of such asset is necessary. The effect of any impairment would be to expense the difference between the fair value of such asset and its carrying value.

We review goodwill at least annually for impairment based on the fair value method prescribed in FASB's authoritative guidance entitled *Goodwill*. At December 31, 2011, we determined, based on a third party valuation that no impairment existed. See also Note 13 *Purchase of Inventory, Fixed Assets, and Intangible Assets of Venture Metals, LLC* in the Notes to Consolidated Financial Statements for information relating to this valuation.

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 of Financial Instruments.

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. See also Note 1 Summary of Significant Accounting Policies Intangibles, and Note 13 Purchase of Inventory, Fixed Assets, and Intangible Assets of Venture Metals, LLC in the Notes to Consolidated Financial Statements.

Derivative Instruments

Beginning in 2008, we have utilized derivative instruments in the form of interest rate swaps to assist in managing our interest rate risk. We do not enter into any interest rate swap derivative instruments for trading purposes. We account for the interest rate swaps in accordance with FASB's authoritative guidance entitled Accounting for Derivative Instruments and Hedging Activities, as amended, which requires us to include the change in fair value of the interest rate swap in other comprehensive income.

Income Taxes

We account for income taxes under the asset and liability method. We recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. We measure deferred tax assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which we expect to recover or settle those temporary differences. We recognize the effect on deferred tax assets and liabilities of a change in tax rates in income in the period that includes the enactment date.

Results of Operations

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

| Year ended December 31, | 2011 | 2010 | 2009 |
|--|---------|---------|--------|
| Consolidated Statements of Income Data: | | | |
| Total revenue | 100.00% | 100.00% | 100.0% |
| Total cost of goods sold | 97.0% | 92.0% | 88.8% |
| Selling, general and administrative expenses | 4.6% | 4.0% | 5.8% |
| Income (loss) before other income (expense) | (1.6%) | 4.0% | 5.4% |

The 5.0% increase in cost of goods sold as a percentage of revenue in 2011 as compared to 2010 is due to a 19.3% decrease in revenue due to lower demand for stainless steel, but only a 14.9% decrease in cost of goods sold. The lower percentage decrease in cost of goods sold is partially due to lower margins beginning in August 2011 and the inventory write down to lower of cost or market of \$3.4 million as metal prices dropped in the last half of 2011. Increases in repairs and maintenance expenses, labor expenses, depreciation expense, and fuel, lubricant, and hauling expenses also increased the cost of goods sold percentage.

The 3.2% increase in cost of goods sold as a percentage of revenue in 2010 as compared to 2009 is due to increased processing fees, utility expense, and repairs and maintenance relating to the shredder. The shredder was placed in production in July, 2009, so only one half of 2009 included such expenses. A full year of these expenses is included in 2010.

Accumulated Other Comprehensive Income (Loss)

Comprehensive income is net income plus certain other items that are recorded directly to shareholders' equity. Amounts included in other accumulated comprehensive loss for our derivative instruments are recorded net of the related

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

income tax effects. Refer to Note 1 Derivative and Hedging Activities in the Notes to Consolidated Financial Statements for additional information about our derivative instruments. The following table gives further detail regarding the composition of other accumulated comprehensive income (loss) at December 31, 2011 and 2010.

| | |
|--|----------|
| Total accumulated other comprehensive loss as of 1/1/10 | \$ (338) |
| Net unrealized loss on derivative instruments, net of tax, during 2010 | (15) |
| | (353) |
| Total accumulated other comprehensive loss as of 12/31/10 | (353) |
| Net unrealized gain on derivative instruments, net of tax, during 2011 | 63 |
| | 63 |
| Total accumulated other comprehensive loss as of 12/31/11 | \$ (290) |
| | (290) |

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Total revenue decreased \$66.1 million or 19.3% to \$276.9 million in 2011 compared to \$343.0 million in 2010. Recycling revenue decreased \$65.2 million or 19.5% to \$269.5 million in 2011 compared to \$334.7 million in 2010. This change was primarily due to a 107.0 million pound or 49.8% decrease in the volume of stainless steel shipments due to a decrease in worldwide stainless steel demand beginning in the second quarter. Substantially all of our stainless steel sales are to one customer. In response to the overall decrease in demand for stainless steel, this customer decreased our sales orders received in each of the last three quarters of the year. The volume of other nonferrous materials shipments also decreased by 2.1 million pounds, or 6.7%. In 2011, sales to existing recycling dealers decreased by approximately \$75.2 million, or 23.1%. New dealer sales in 2011 totaled approximately \$16.3 million, while lost dealer sales totaled only \$6.9 million in 2010. In addition to the reduction in volume, total revenue was also affected by the decrease in overall average commodity prices for all materials shipped by \$66.90 per gross ton, or 7.0%. Specifically as of December, nickel prices on the London Metal Exchange decreased 40% since the first quarter, falling to their lowest level in November 2011. Nickel is a key commodity used in stainless steel blends. These decreases were partially offset by a 14.6 thousand gross ton, or 7.5%, increase in the volume of ferrous shipments. Waste Services revenue decreased \$0.9 million or 11.1% to \$7.4 million in 2011 compared to \$8.3 million in 2010. This decrease was primarily due to a decrease in management revenue of \$0.9 million caused by the loss of several large customers in the first and second quarters. The decrease was partially offset by the gain of one large customer in the third quarter.

Total cost of goods sold decreased \$47.1 million or 14.9% to \$268.6 million in 2011 compared to \$315.7 million in 2010. Recycling cost of goods sold decreased \$46.4 million or 15.0% to \$263.1 million in 2011 compared to \$309.5 million in 2010. This decrease was primarily due to a decrease in the volume of purchases of stainless steel of 131.9 million pounds, or 59.0% along with the decreased volume of shipments noted above. Overall average commodity prices for materials purchased decreased \$108.57 per gross ton, or 12.8%. Other decreases in cost of goods sold were as follows:

- a decrease of \$0.5 million in processing costs;
- a decrease of \$0.2 million in torching materials expense; and
- a decrease of \$0.2 million in depreciation expense.

These decreases were partially offset by an increase in the volume of ferrous purchases of 24.2 thousand gross tons, or 10.7%, and of nonferrous purchases of 6.8 million pounds, or 19.3%, as well as the following:

- a \$3.4 million write-down of the value of stainless steel inventory to lower of cost or market due to the recent decreases in stainless steel demand and commodity prices, especially nickel;
- an increase of \$0.6 million in repairs and maintenance expenses;
- an increase of \$0.6 million in labor expenses; and
- an increase of \$0.4 million in fuel, lubricant, and hauling costs.

Waste Services cost of goods sold decreased \$0.7 million or 9.9% to \$5.5 million in 2011 compared to \$6.2 million in 2010 primarily due to the loss of customers mentioned above. We have reclassified certain expenses in our income statement to more accurately reflect segment performance and we have reclassified cost of goods sold and selling, general and administrative expenses for the year ended December 31, 2009 to be consistent with current presentation. These reclassifications had no effect on previously reported net income.

We make certain assumptions regarding future demand, current replacement costs and net realizable value in order to assess that we have properly recorded inventory at the lower of cost or market. We base our assumptions on historical experience, current market conditions and current replacement costs. Due to declines in the anticipated future selling prices of scrap metal and finished steel products, we recorded non-cash net realizable value inventory adjustments of \$3.4 million in the

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

third quarter of 2011 to reduce the value of our inventory (and increase cost of goods sold) to the lower of cost or market. No such adjustment was made in 2010 or 2009.

Selling, general and administrative (SG&A) expenses decreased \$1.0 million or 7.4% to \$12.7 million in 2011 compared to \$13.7 million in 2010. The decrease in SG&A expenses was primarily due to the following:

- a net decrease in stock and cash bonuses of \$2.3 million; and
- a decrease in labor expenses of \$0.5 million.

These decreases were partially offset by the following:

- an increase in fuel and lubricants and hauling expenses of \$0.4 million;
- an increase in legal fees of \$0.3 million;
- an increase in depreciation and amortization of \$0.8 million;
- an increase in repair and maintenance expenses of \$0.1 million;
- an increase in insurance expense of \$0.1 million; and
- an increase in the management fee, directors' fees, consulting fees, and compliance expenses of \$0.1 million.

As a percentage of total revenue, selling, general and administrative expenses were 4.6% in 2011 compared to 4.0% in 2010.

Interest expense increased \$0.5 million or 37.5% to \$2.0 million in 2011 compared to \$1.5 million in 2010 due to higher levels of debt in the first three quarters of 2011 compared to that same period in 2010. The increase in debt, mainly the revolving credit facility with the Bank, allows for funding temporary fluctuations in accounts receivable and inventory. We also purchased additional equipment using debt facilities.

Other loss was \$0.6 million in 2011 compared to other income of \$41.0 thousand in 2010, a decrease of \$0.6 million, as outlined in the table below describing the significant components for each year. The \$0.5 million increase in other expense resulted from the need to cancel purchase contracts due to the decrease in demand for stainless steel in the second quarter of 2011. These contracts required the Company to pay \$0.5 million in termination fees. The Company chose to terminate these purchase contracts because the purchase contracts cancelled were valued at approximately \$2.4 million, an amount well above the prevailing market price of the underlying commodities. Because the Company can purchase these commodities in the market at lower cost when needed to fill new shipment orders, management determined that the Company could benefit from market volatility by cancelling these contracts, even after paying the termination fees.

Significant components of other income (expense), in thousands, were as follows:

| Description Other Income (Expense) | Fiscal Year Ended December 31 | |
|------------------------------------|----------------------------------|----------------|
| | 2011 | 2010 |
| Lennox Industries legal settlement | \$ (84.5) | \$ |
| Fee to cancel purchase contracts | (500.0) | |
| Other | 18.5 | 41.0 |
| Total other income, net | \$ (566.0) | \$ 41.0 |

The income tax provision decreased \$7.4 million to a credit of \$3.0 million in 2011 compared to a provision of \$4.4 million in 2010 due to the loss reported in 2011, which included the inventory write-down of \$3.4 million. The effective tax rates in 2011 and 2010 were 43.9% and 35.2% based on federal and state statutory rates. In 2011, the Internal Revenue Service conducted an examination of our 2009 income tax return and, per the final report, proposed changes amounting to approximately \$735.0 thousand of additional taxes due for which we expect to receive an invoice early in 2012. This adjustment arose from our use of bonus depreciation rules for certain additions to shredding equipment which were determined to be disqualified for bonus depreciation. This resulting adjustment to 2009 depreciation deductions allowed us to file an amended U.S. tax return for 2010, pursuant to which we claimed additional depreciation deductions and resulting in a claim for a refund of income taxes paid amounting to approximately \$113.0 thousand. The additional tax and refund due have both been accrued as of December 31, 2011. In 2010, we received a state tax credit for the purchase of the shredder equipment as well as a Domestic Production Activity Deduction. Refer to Note 4 – Income Taxes – in the Notes to Consolidated Financial Statements.

Financial Condition at December 31, 2011 compared to December 31, 2010

Cash and cash equivalents decreased \$0.2 million to \$2.3 million as of December 31, 2011 compared to \$2.5 million at December 31, 2010.

Net cash from operating activities was \$19.0 million for the year ending December 31, 2011, compared to net cash used in operating activities of \$5.8 million for the same period in 2010. The increase in net cash from operating activities is primarily due to decreases in inventories of \$15.8 million and in receivables of \$10.2 million, partially offset by an increase in income tax receivable of \$4.0 million and decreases in accounts payable of \$0.7 million, decreases in income tax payable of \$2.9 million, and decreases in accrued bonuses of \$1.2 million. The decreases in inventories and receivables relate to the decrease in demand for stainless steel and other nickel-based scrap metal beginning in the second quarter, thus lowering both sales and purchasing activity. We also paid \$0.5 million in termination fees to cancel several purchase contracts in the second quarter of 2011 and made timely payments to our vendors, which decreased our outstanding accounts payable balance in 2011.

We used net cash in investing activities of \$2.3 million for the year ending December 31, 2011 compared to \$3.7 million for the same period in 2010. The difference of \$1.4 million was primarily due to purchasing \$1.4 million less in property and equipment in 2011 as compared to 2010. In 2011, we used \$0.7 million for road and building improvements. We purchased recycling and rental fleet equipment, shredder system equipment, and office equipment of \$1.4 million. The rental fleet equipment consists of solid waste handling and recycling equipment such as compactors, waste edge monitors, balers, and carts. It is our intention to continue to pursue this market. We also used \$0.3 million to purchase and upgrade vehicles. We received \$0.2 million from sales of our rental fleet compactors, balers, and containers. We paid deposits of \$36.6 thousand on machinery and equipment.

We used net cash in financing activities of \$16.9 million in the year ending December 31, 2011 compared to net cash from financing activities of \$11.2 million for the same period in 2010, a difference of \$28.1 million. The primary source of the net cash decrease was a decrease in proceeds from long-term debt totaling \$0.3 million in 2011 compared to \$45.0 million in 2010. This decrease was partially offset by a decrease in payments on long term debt totaling \$17.3 million in 2011 compared to \$33.8 million in 2010. There were no cash dividends paid or common stock repurchases in 2011 or 2010.

Trade accounts receivable after allowances for doubtful accounts decreased \$10.2 million or 37.4% to \$17.2 million as of December 31, 2011 compared to \$27.4 million as of December 31, 2010. This change was primarily due to the decreased volume of stainless steel and ferrous shipments in the fourth quarter of 2011.

Recycling accounts receivable decreased \$8.6 million or 34.5% to \$16.3 million as of December 31, 2011 compared to \$24.9 million as of December 31, 2010. This change was primarily due to stainless steel sales and the timing of the receipt of payment related to these sales as well as a decrease in the volume of stainless steel, ferrous, and nonferrous shipments in the fourth quarter. On average, the volume of stainless steel shipments decreased 43.8 million pounds or 69.4%, the volume of ferrous shipments decreased 10.6 gross tons or 19.7%, and the volume of nonferrous shipments decreased 218.7 thousand pounds or 2.6% in the fourth quarter of 2011 compared to the same period in 2010. On average, overall prices decreased \$268.39 per gross ton or 26.1% in the fourth quarter of 2011 compared to the same period in 2010.

Waste Services accounts receivable decreased \$0.2 million or 17.5% to \$0.9 million as of December 31, 2011 compared to \$1.1 million as of December 31, 2010. In general, the accounts receivable balance fluctuates due to the timing of services and receipt of customer payments.

Inventories for sale consist principally of stainless steel alloys, ferrous and nonferrous scrap materials and waste equipment machinery held for resale. We value inventory at the lower of cost or market. We use the replacement parts included in inventory within a one-year period as these parts wear out quickly due to the high-volume and intensity of the shredder function. We depreciate these replacement parts over a one-year life. Inventory decreased \$15.8 million or 46.0% to \$18.5 million as of December 31, 2011 compared to \$34.3 million as of December 31, 2010. With lower demand for stainless steel causing fewer sales orders in the second quarter, we decreased purchasing activity and cancelled several purchase contracts. Overall, we decreased the volume of stainless steel purchases by 131.9 million pounds or 59.0% for the year. Lower demand also put downward pressure on metal prices. We made an adjustment of approximately \$3.4 million to lower our stainless steel inventory value to the market value in the third quarter. These decreases were partially offset by an increase in the volume of ferrous purchases of 24.2 gross tons or 10.7%, and an increase in the volume of nonferrous purchases of 6.8 million pounds or 19.3% in 2011 as compared to 2010. Inventories, in thousands, as of December 31, 2011 and December 31, 2010 consisted of the following:

| | <u>2011</u> | <u>2010</u> |
|---|-------------------|-------------------|
| Stainless steel, ferrous, and non-ferrous materials | \$ 16,819 | \$ 32,864 |
| Waste equipment machinery | 39 | 75 |
| Other | 63 | 59 |
| | <u> </u> | <u> </u> |
| Total inventories for sale | 16,921 | 32,998 |
| Replacement parts | 1,623 | 1,313 |
| | <u> </u> | <u> </u> |
| Total inventories | \$ 18,544 | \$ 34,311 |

As of December 31, 2011, stainless steel inventory consisted of 14.3 million pounds at a unit cost of \$0.691 per pound, which includes processing costs. As of December 31, 2010, stainless steel inventory consisted of 31.8 million pounds at a unit cost of \$0.777 per pound. As of December 31, 2011, ferrous inventory consisted of 9.9 thousand gross tons at a unit cost, including processing costs, of \$449.74 per gross ton. As of December 31, 2010, ferrous inventory consisted of 15.9 thousand gross tons at a unit cost, including processing costs, of \$396.84 per gross ton. As of December 31, 2011, nonferrous inventory consisted of 2.3 million pounds with a unit cost, including processing costs, of \$1.087 per pound. As of December 31, 2010, nonferrous inventory consisted of 1.8 million pounds at a unit cost, including processing costs, of \$1.048 per pound.

We make certain assumptions regarding future demand and net realizable value in order to assess whether inventory is properly recorded at the lower of cost or market. We base our assumptions on historical experience, current market conditions and current replacement costs. Due to declines in the anticipated future selling prices of scrap metal and finished steel products, we recorded a non-cash net realizable value (NRV) inventory adjustment of \$3.4 million in the third quarter 2011 to reduce the value of our inventory (and increase cost of goods sold) to the lower of cost or market. No such adjustment was made in 2010.

| Year | Inventory Type | Pounds | Unit Cost | Amount |
|------|-----------------|------------|------------|---------------|
| 2011 | Stainless Steel | 14,333,732 | \$ 0.691 | \$ 9,911,380 |
| 2010 | Stainless Steel | 31,818,693 | \$ 0.777 | \$ 24,714,342 |
| Year | Inventory Type | Gross Tons | Unit Cost | Amount |
| 2011 | Ferrous | 9,885 | \$ 449.741 | \$ 4,445,821 |
| 2010 | Ferrous | 15,866 | \$ 396.840 | \$ 6,296,255 |
| Year | Inventory Type | Pounds | Unit Cost | Amount |
| 2011 | Non-ferrous | 2,265,388 | \$ 1.087 | \$ 2,461,694 |
| 2010 | Non-ferrous | 1,769,283 | \$ 1.048 | \$ 1,853,424 |

Inventory aging for the period ended December 31, 2011 (Days Outstanding):

| Description | (in thousands) | | | | Total |
|--|------------------|-----------------|---------------|-----------------|------------------|
| | 1 - 30 | 31 - 60 | 61 - 90 | Over 90 | |
| Stainless steel, ferrous and non-ferrous materials | \$ 11,160 | \$ 1,475 | \$ 424 | \$ 3,760 | \$ 16,819 |
| Replacement parts | 1,623 | | | | 1,623 |
| Waste equipment machinery | | | | 39 | 39 |
| Other | 63 | | | | 63 |
| Total | \$ 12,846 | \$ 1,475 | \$ 424 | \$ 3,799 | \$ 18,544 |

Inventory aging for the period ended December 31, 2010 (Days Outstanding):

| Description | (in thousands) | | | | Total |
|--|------------------|-----------------|-----------------|-----------------|------------------|
| | 1 - 30 | 31 - 60 | 61 - 90 | Over 90 | |
| Stainless steel, ferrous and non-ferrous materials | \$ 25,062 | \$ 5,450 | \$ 1,184 | \$ 1,168 | \$ 32,864 |
| Replacement parts | 1,313 | | | | 1,313 |
| Waste equipment machinery | | | | 75 | 75 |
| Other | 59 | | | | 59 |
| Total | \$ 26,434 | \$ 5,450 | \$ 1,184 | \$ 1,243 | \$ 34,311 |

Inventory in the Over 90 days category as of December 31, 2011 includes several materials that are bought in bulk for pricing and used sparingly in blends. We purchased these materials prior to the decrease in demand for stainless steel and other nickel-based scrap. We adjusted the value of several of these materials to lower of cost or market in the third quarter due to the drop in market prices at that time. We did not use much of these materials in the latter part of the year due to the decreased demand for stainless steel and other nickel-based scrap metals beginning in the second quarter. We cannot assure that global demand will improve in the near term.

Accounts payable trade decreased \$0.7 million or 6.4% to \$10.7 million as of December 31, 2011 compared to \$11.4 million as of December 31, 2010. Recycling accounts payable increased \$0.2 million or 2.2% to \$9.5 million as of December 31, 2011 compared to \$9.3 million as of December 31, 2010. This increase was primarily due to increased purchasing of stainless steel materials near the end of the year and by an increase in the volume of purchases for nonferrous materials of 1.7 million pounds, or 17.2% in the fourth quarter of 2011 as compared to the same period in 2010. Overall, there was a decrease in the volume of purchases for stainless steel materials of 54.2 million pounds, or 77.5% and for ferrous materials of 16.9 gross tons, or 27.1% in the fourth quarter of 2011 as compared to the same period in 2010. The overall average commodity purchase prices for all materials decreased by \$199.4 per gross ton, or 22.0%. Our accounts payable payment policy in the recycling segment is consistent between years.

Waste Services accounts payable decreased \$0.3 million or 19.5% to \$1.0 million as of December 31, 2011 compared to \$1.3 million as of December 31, 2010. This change was due to market conditions and the timing of payments.

Working capital decreased \$17.9 million to \$29.4 million as of December 31, 2011 compared to \$47.3 million as of December 31, 2010. Decreases in net accounts receivable of \$10.2 million, in inventories of \$15.8 million, and in deferred income taxes of \$0.5 million were positive contributors to working capital in 2011, partially offset by an increase in income tax receivable of \$4.0 million and decreases in accounts payable of \$0.7 million, income tax payable of \$2.9 million, and accrued bonus of \$1.2 million. During 2011, we used these positive working capital contributors to purchase or make deposits on property and equipment of \$2.5 million and to decrease our revolving debt.

Contractual Obligations

The following table provides information with respect to our known contractual obligations for the year ended December 31, 2011:

| Obligation Description (2) | Payments due by period (in thousands) | | | | |
|---------------------------------|---------------------------------------|------------------|-------------|-------------|-------------------|
| | Total | Less than 1 year | 1 - 3 years | 3 - 5 years | More than 5 years |
| Long-term debt obligations | \$ 28,509 | \$ 1,821 | \$ 26,653 | \$ 35 | \$ |
| Operating lease obligations (1) | 1,125 | 721 | 252 | 152 | |
| Total | \$ 29,634 | \$ 2,542 | \$ 26,905 | \$ 187 | \$ |

- (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 with automatic annual renewals thereafter unless one party provides written notice to the other party of its intent not to renew at least six months in advance of the next renewal date. We have monthly rental payments of \$48.5 thousand through December 2012. In the event of a change of control, the monthly payments become \$62.5 thousand. See Item 2. Properties -- Related Parties Agreements.

We also lease equipment from K&R, LLC for which monthly payments of \$5.5 thousand are due through October 2015 and monthly payments of \$5.0 thousand are due through April 2016.

We lease a management services operations facility and various pieces of equipment in Dallas, Texas for which monthly payments of \$1.0 thousand are due through September 2012.

We subleased the Lexington property to an unaffiliated third party for a term commencing March 1, 2007 and ending January 31, 2012 for \$4.5 thousand per month. We leased this property from an unrelated party for \$4.5 thousand per month. The lease terminated on February 10, 2012.

- (2) All interest commitments under interest-bearing debt are included in this table, excluding the interest rate swaps, for which changes in value are accounted for in other comprehensive income.

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009

Total revenue increased \$162.0 million or 89.5% to \$343.0 in 2010 compared to \$181.0 million in 2009. Recycling revenue increased \$162.8 or 94.8% to \$334.7 in 2010 compared to \$171.8 in 2009. This change was primarily due to a 54.3 million pound, or 33.9%, increase in the volume of stainless steel shipments, a 95.5 thousand gross ton, or 96.8%, increase in the volume of ferrous shipments, and a 1.6 million pound, or 5.2%, increase in the volume of nonferrous shipments. In 2010, sales to existing Recycling dealers increased by approximately \$153.0 million, or 98.3%. New dealer sales in 2010 totaled approximately \$24.4 million, while lost dealer sales totaled only \$4.4 million in 2009. Overall average commodity prices for materials shipped increased \$112.26 per gross ton, or 13.3%. Waste Services revenue decreased \$872.3 thousand or 9.5% to \$8.3 million in 2010 compared to \$9.2 million in 2009. This decrease was primarily due to a decrease in management revenue of \$1.5 million caused by the permanent loss of two major customers due to bankruptcy and a net decrease in sales to other customers, partially offset by several new customers in 2010 and an increase in cardboard revenue of \$410.2 thousand due to an increase in average cardboard prices throughout 2010.

Total cost of goods sold increased \$155.0 million or 96.4% to \$315.7 million in 2010 compared to \$160.8 million in 2009. Recycling cost of goods sold increased \$155.0 million or 100.3% to \$309.5 million in 2010 compared to \$154.5 million in 2009. This increase was primarily due to an increase in the volume of purchases of stainless steel of 37.1 million pounds, or 20.1%, of ferrous purchases of 121.3 thousand gross tons, or 115.3%, and of nonferrous purchases of 6.4 million pounds, or 22.5% along with the increased volume of shipments noted above. Overall average commodity prices for materials purchased increased \$57.43 per gross ton, or 7.3%. Other increases in cost of goods sold were as follows:

An increase of \$6.2 million in processing costs;

An increase of \$1.2 million in labor expenses;
 An increase of \$830.7 thousand in repairs and maintenance expenses;
 An increase of \$741.6 thousand in depreciation expense;
 An increase of \$670.0 thousand in utilities expenses; and
 An increase of \$209.3 thousand in fuel and lubricant costs.

These increases were partially offset by a decrease in bonus expense of \$1.3 million.

Waste Services cost of goods sold decreased \$0.1 million or 0.6% to \$6.2 million in 2010 compared to \$6.3 in 2009.

Selling, general and administrative (SG&A) expenses increased \$3.2 million or 31.0% to \$13.7 million in 2010 compared to \$10.5 million in 2009. The increase in SG&A expenses was primarily due to the following:

a net increase in stock bonuses, stock options, and cash bonuses of \$1.8 million;
 an increase in the management fee, consulting fees, and compliance expenses of \$351.1 thousand;
 an increase in amortization of \$375.0 thousand;
 an increase in sales and service managers and supervisors labor expenses of \$252.4 thousand;
 an increase in insurance expense of \$119.2 thousand;
 an increase in fuel and lubricants and hauling expenses of \$104.4 thousand;
 an increase in operating supplies of \$101.1 thousand; and
 an increase in benefits of \$82.7 thousand.

As a percentage of total revenue, selling, general and administrative expenses were 4.0% in 2010 compared to 5.8% in 2009.

Interest expense increased \$0.4 million or 34.4% to \$1.5 million in 2010 compared to \$1.1 million in 2009 due to an increase in long term debt in 2010 compared to 2009. The increase in debt, mainly the revolving credit facility with the Bank, allows for funding temporary fluctuations in accounts receivable and inventory. We also purchased additional equipment using debt facilities.

Other income was \$40.1 thousand in 2010 compared to other loss of (\$29.3) thousand in 2009, an increase of \$69.4 thousand, as outlined in the table below describing the significant components for each year. In the first quarter of 2009, we paid an additional \$65.6 thousand for legal and court costs associated with the settlement of a prior year court case.

Significant components of other income (expense) in thousands were as follows:

| Description Other Income (Expense) | Fiscal Year Ended December 31 | |
|---------------------------------------|----------------------------------|------------------|
| | 2010 | 2009 |
| Additional settlement to AAR | \$ | \$ (65.6) |
| Other | 40.1 | 36.3 |
| Total other income, net | \$ 40.1 | \$ (29.3) |

The income tax provision is 35.5% for the year ended December 31, 2010 compared to 39.8% for the year ended December 31, 2009 based on federal and state statutory rates. We received a tax credit for the purchase of the shredder equipment as well as a Domestic Production Activity Deduction in 2010. Refer to Note 4 Income Taxes in the Notes to Consolidated Financial Statements.

Financial Condition at December 31, 2010 compared to December 31, 2009

Cash and cash equivalents increased \$1.8 million to \$2.5 million as of December 31, 2010 compared to \$0.7 million at December 31, 2009.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

We used net cash from operating activities of \$5.8 million for the year ending December 31, 2010, compared to using net cash from operating activities of \$5.6 million for the same period in 2009.

We used net cash from investing activities of \$3.7 million for the year ending December 31, 2010 compared to \$19.6 million for the same period in 2009. The difference of \$15.9 million was primarily due to \$11.9 million related to the acquisition of Venture Metals, LLC land, fixed assets, goodwill, and inventory in 2009, and \$6.5 million spent on the shredder

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

system in 2009, partially offset by an increase of \$2.7million in purchases of and deposits on other property, plant, and equipment in 2010 compared to 2009.

Net cash from financing activities decreased \$13.5 million to \$11.2 million for the year ending December 31, 2010 compared to \$24.7 million for the same period in 2009. The primary source of the net cash decrease was an increase in payments on long-term debt totaling \$33.8 million in 2010 compared to \$2.4 million in 2009. This decrease was offset by an increase in borrowings totaling \$45.0 million in 2010 compared to \$27.2 million in 2009. There were no cash dividends paid or common stock repurchases in 2010 or 2009.

Trade accounts receivable after allowances for doubtful accounts increased \$18.9 million or 222.5% to \$27.4 million as of December 31, 2010 compared to \$8.5 million as of December 31, 2009. This change was primarily due to the increased volume of stainless steel and ferrous shipments in the fourth quarter.

Recycling accounts receivable increased \$17.4 million or 231.5% to \$24.9 million as of December 31, 2010 compared to \$7.5 million as of December 31, 2009. This change was primarily due to stainless steel sales and the timing of the receipt of payment related to these sales as well as an increase in the volume of stainless steel and ferrous shipments in the fourth quarter. On average, the volume of stainless steel shipments in pounds increased 360.1% and ferrous shipments in gross tons increased 51.3% in the fourth quarter of 2010 compared to the same period in 2009. On average, stainless steel prices increased 42.0% and ferrous sales prices increased 13.5% in the fourth quarter of 2010 compared to the same period in 2009. On average, the volume of nonferrous shipments in pounds decreased 16.8% in the fourth quarter of 2010 compared to the fourth quarter of 2009. On average, nonferrous sales prices increased 37.3% in the fourth quarter of 2010 compared to the same period in 2009.

Waste Services accounts receivable increased \$159.6 thousand or 16.3% to \$1.1 million as of December 31, 2010 compared to \$980.9 thousand as of December 31, 2009. This increase relates to larger write offs of bankruptcy related customer accounts in 2009, a lower portion of the allowance for doubtful accounts allocated to Waste Services in 2010 after collecting or writing off accounts, as well as the timing of the receipt of payments.

Inventories for sale consist principally of stainless steel alloys, ferrous and nonferrous scrap materials and waste equipment machinery held for resale. We value inventory at the lower of cost or market. We use the replacement parts included in inventory within a one-year period as these parts wear out quickly due to the high-volume and intensity of the shredder function. We depreciate these replacement parts over a one-year life. Inventory increased \$7.9 million or 29.8% to \$34.3 million as of December 31, 2010 compared to \$26.4 million as of December 31, 2009. The primary reason for the significant increase in inventory was an increase in the volume of stainless steel purchases of 20.1%, an increase in the volume of ferrous purchases of 115.3%, and an increase in the volume of nonferrous purchases of 22.5% in 2010 as compared to 2009. Inventories as of December 31, 2010 and December 31, 2009 consisted of the following (in thousands):

| | December 31, 2010 | December 31, 2009 |
|----------------------------|------------------------------|------------------------------|
| | <u> </u> | <u> </u> |
| Stainless steel alloys | \$ 24,714 | \$ 21,549 |
| Ferrous materials | 6,296 | 1,588 |
| Non-Ferrous materials | 1,854 | 2,219 |
| Waste equipment machinery | 75 | 102 |
| Other | 59 | 89 |
| | <u> </u> | <u> </u> |
| Total inventories for sale | 32,998 | 25,547 |
| Replacement parts | 1,313 | 880 |
| | <u> </u> | <u> </u> |
| Total inventories | <u>\$ 34,311</u> | <u>\$ 26,427</u> |

As of December 31, 2010, stainless steel inventory consisted of 31.8 million pounds at a unit cost of \$0.777 per pound, which includes processing costs. As of December 31, 2009, stainless steel inventory consisted of 26.1 million pounds at a unit cost of \$0.826 per pound. As of December 31, 2010, ferrous inventory consisted of 15.9 thousand gross tons at a unit cost, including processing costs, of \$396.8 per gross ton. As of December 31, 2009, ferrous inventory consisted of 5.8 thousand gross tons at a unit cost, including processing costs, of \$272.061 per gross ton. As of December 31, 2010, nonferrous inventory consisted of 1.8 million pounds with a unit cost, including processing costs, of \$1.048 per pound. As of December 31, 2009, nonferrous inventory consisted of 1.8 million pounds at a unit cost, including processing costs, of \$1.209 per pound.

We make certain assumptions regarding future demand and net realizable value in order to assess that inventory is properly recorded at the lower of cost or market. We base our assumptions on historical experience, current market conditions and current replacement costs. Due to declines in the anticipated future selling prices of scrap metal and finished steel

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

products, we recorded non-cash net realizable value (NRV) inventory adjustments of \$1.2 million in the fourth quarter 2008 to reduce the value of our inventory (and increase cost of goods sold) to the lower of cost or market. Such an adjustment was not necessary in 2010 or 2009.

| Year | Inventory Type | Pounds | Unit Cost | Amount |
|------|-----------------|------------|------------|---------------|
| 2010 | Stainless Steel | 31,818,693 | \$ 0.777 | \$ 24,714,342 |
| 2009 | Stainless Steel | 26,086,771 | \$ 0.826 | \$ 21,549,014 |
| Year | Inventory Type | Gross Tons | Unit Cost | Amount |
| 2010 | Ferrous | 15,866 | \$ 396.840 | \$ 6,296,255 |
| 2009 | Ferrous | 5,835 | \$ 272.061 | \$ 1,587,475 |
| Year | Inventory Type | Pounds | Unit Cost | Amount |
| 2010 | Nonferrous | 1,769,283 | \$ 1.048 | \$ 1,853,424 |
| 2009 | Nonferrous | 1,835,719 | \$ 1.209 | \$ 2,219,137 |

Inventory aging for the period ended December 31, 2010 (Days Outstanding):

| Description | (in thousands) | | | | |
|--|------------------|-----------------|-----------------|-----------------|------------------|
| | 1 - 30 | 31 - 60 | 61 - 90 | Over 90 | Total |
| Stainless steel, ferrous and non-ferrous materials | \$ 25,062 | \$ 5,450 | \$ 1,184 | \$ 1,168 | \$ 32,864 |
| Replacement parts | 1,313 | | | | 1,313 |
| Waste equipment machinery | | | | 75 | 75 |
| Other | 59 | | | | 59 |
| Total | \$ 26,434 | \$ 5,450 | \$ 1,184 | \$ 1,243 | \$ 34,311 |

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

| Description | (in thousands) | | | | |
|--|------------------|-----------------|-----------------|-----------------|------------------|
| | 1 - 30 | 31 - 60 | 61 - 90 | Over 90 | Total |
| Stainless steel, ferrous and non-ferrous materials | \$ 15,053 | \$ 2,855 | \$ 5,238 | \$ 2,210 | \$ 25,356 |
| Replacement parts | 880 | | | | 880 |
| Waste equipment machinery | 10 | | | 92 | 102 |
| Other | 89 | | | | 89 |
| Total | \$ 16,032 | \$ 2,855 | \$ 5,238 | \$ 2,302 | \$ 26,427 |

Accounts payable trade increased \$6.7 million or 143.5% to \$11.4 million as of December 31, 2010 compared to \$4.7 million as of December 31, 2009. Recycling accounts payable increased \$6.2 million or 196.1% to \$9.3 million as of December 31, 2010 compared to \$3.1 million as of December 31, 2009. This increase was primarily due to the increases in the volumes of purchases for stainless steel of 152.41%, for ferrous materials of 90.9%, and for nonferrous materials of 21.6% in the fourth quarter of 2010 as compared to the same period in 2009, as well as the overall average commodity purchase prices for these materials increased by 78.0%. Our accounts payable payment policy in the recycling segment is consistent between years.

Waste Services accounts payable increased \$6.7 thousand or 0.5% to \$1.3 million as of December 31, 2010 compared to \$1.3 million as of December 31, 2009. This change was due to market conditions and the timing of payments.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

Working capital increased \$36.0 million to \$47.3 million as of December 31, 2010 compared to \$11.3 million as of December 31, 2009. Increases in net accounts receivable of \$18.9 million and in inventories of \$7.9 million, and decreases in the current maturities of long-term debt of \$10.7 million and the note payable to BB&T of \$5.0 million were positive contributors to working capital in 2010, offset by increases in accounts payable of \$6.7 million and income tax payable of \$2.4 million.

During 2010, we used these positive working capital contributors to purchase or make deposits on property and equipment of \$4.1 million.

Inflation and Prevailing Economic Conditions

To date, inflation has not and is not expected to have a significant impact on our operation in the near term. We have no long-term fixed-price contracts and we believe we will be able to pass through most cost increases resulting from inflation to our customers. We are susceptible to the cyclical nature of the commodity business. In response to these economic conditions, we have expanded the recycling area of the business and continue to focus on the management consulting area of the business and are working to liquidate inventories while we make efforts to enhance gross margins.

Impact of Recently Issued Accounting Standards

In September 2011, the FASB issued ASU No. 2011-08, an amendment to Topic 350, Intangibles—Goodwill and Other, which simplifies how entities test goodwill for impairment. Previous guidance under Topic 350 required an entity to test goodwill for impairment using a two-step process on at least an annual basis. First, the fair value of a reporting unit was calculated and compared to its carrying amount, including goodwill. Second, if the fair value of a reporting unit was less than its carrying amount, the amount of impairment loss, if any, was required to be measured. Under the amendments in this update, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads the entity to determine that it is more likely than not that its fair value is less than its carrying amount. If after assessing the totality of events or circumstances, an entity determines that it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then the two-step impairment test is unnecessary. If the entity concludes otherwise, then it is required to test goodwill for impairment under the two-step process as described under paragraphs 350-20-35-4 and 350-20-35-9 under Topic 350. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, the quarter ending March 31, 2012 for us, and early adoption is permitted. We do not expect the adoption of ASU 2011-08 will have a material impact on our Condensed Consolidated Financial Statements.

In June 2011, the FASB issued ASU 2011-05, which is an update to Topic 220, Comprehensive Income. This update eliminates the option of presenting the components of other comprehensive income as part of the statement of changes in stockholders' equity, requires consecutive presentation of the statement of net income and other comprehensive income and requires reclassification adjustments from other comprehensive income to net income to be shown on the financial statements. ASU 2011-05 is effective for all interim and annual reporting periods beginning after December 15, 2011, the quarter ending March 31, 2012 for us. However, ASU 2011-12 has deferred the specific requirement within ASU 2011-05 to present on the face of the financial statements items that are reclassified from accumulated other comprehensive income to net income separately with their respective components of net income and other comprehensive income. Entities should continue to report reclassifications out of accumulated comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. We do not expect a material impact on our financials due to the implementation of this guidance. As ASU No. 2011-05 relates only to the presentation of Comprehensive Income, we do not expect the adoption of this update will have a material effect on our Condensed Consolidated Financial Statements.

In May 2011, the FASB issued ASU No. 2011-04, which is an update to Topic 820, Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments in this ASU generally represent clarification of Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and IFRS. The amendments are effective for interim and annual periods beginning after December 15, 2011, the quarter ending March 31, 2012 for us, and are to be applied prospectively. Early application is not permitted. We do not expect the adoption of ASU 2011-04 will have a material impact on our Condensed Consolidated Financial Statements.

Item 7A. 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 stainless steel, ferrous and nonferrous metal, and other commodities. The timing and magnitude of industry cycles are difficult to predict and general economic conditions impact the cycles. 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, an adverse impact on our

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

financial results may occur if selling prices fall more quickly than we can adjust purchase prices or if levels of inventory have an anticipated net realizable value that is below average cost.

Our floating rate borrowings expose us to interest rate risk.

In a prior year, we entered into three interest rate swap agreements swapping variable rates for fixed rates. The first swap agreement covers approximately \$4.7 million in debt and commenced April 7, 2009 and matures on April 7, 2014. The second swap agreement covers approximately \$2.1 million in debt and commenced October 15, 2008 and matures on May 7, 2013. The third swap agreement covers approximately \$457.5 thousand 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 December 31, 2011, we recorded the estimated fair value of the liability related to the three swaps at approximately \$484.2 thousand. 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. See Note 3 Notes Payable to Bank in the Notes to Consolidated Financial Statements for an outline of the notional amounts relating to these 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 8. Consolidated Financial Statements and Supplementary Data.

Our consolidated financial statements required to be included in this Item 8 are set forth in Item 15 of this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. 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 December 31, 2011, 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 specified 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) Internal controls over financial reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act). Our internal control over financial reporting includes the process designed by, or under the supervision of, our CEO and CFO, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets;
- provide reasonable assurance that our transactions are recorded as necessary to permit preparation of our financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting cannot prevent or detect every potential misstatement. Therefore, even those systems determined to be effective can provide only reasonable assurances with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may decline.

Our management conducted an evaluation of the effectiveness of our internal control over financial reporting, based on the framework and criteria established in Internal Control -- Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management assessed the effectiveness of our internal control over financial reporting for the year ended December 31, 2011, and concluded that such internal control over financial reporting was effective as of December 31, 2011.

This Annual Report on Form 10-K does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to rules of the SEC that require only management's report in this Annual Report on Form 10-K.

(c) Changes to internal control over financial reporting

There were no changes in ISA's internal control over financial reporting during the year ended December 31, 2011 that have materially affected, or are reasonably likely to affect ISA's internal control over financial reporting.

Item 9B. Other Information.

None.

PART III

Item 10. ISA Directors Executive Officers and Corporate Governance. *

Item 11. Executive Compensation *

Item 12. Security Ownership of Certain Beneficial Owners, Management and Related Stockholder Matters. *

Item 13. Certain Relationships and Related Transactions, and Director Independence. *

Item 14. Principal Accountant Fees and Services. *

* The information required by Items 10, 11, 12, 13 and 14 is or will be set forth in the definitive proxy statement relating to the 2012 Annual Meeting of Shareholders of ISA which is to be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after ISA's year end for the year covered by this report under the Securities Exchange Act of 1934, as amended. Such definitive proxy statement relates to an annual meeting of shareholders and the portions therefrom required to be set forth in this Form 10-K by Items 10, 11, 12, 13 and 14 are incorporated herein by reference pursuant to General Instruction G(3) to Form 10-K.

PART IV

Item 15. Exhibits and Consolidated Financial Statement Schedules.

(a)(1) The following consolidated financial statements of Industrial Services of America, Inc. are filed as a part of this report:

| | <u>Page</u> |
|--|-------------|
| Report of Independent Registered Public Accounting Firm | F-1 |
| Consolidated Balance Sheets as of December 31, 2011 and 2010 | F-2 |
| Consolidated Statements of Income for the years ended December 31, 2011, 2010 and 2009 | F-4 |
| Consolidated Statements of Shareholders' Equity for the years ended December 31, 2011, 2010 and 2009 | F-5 |
| Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009 | F-6 |
| Notes to Consolidated Financial Statements | F-7 |
| (a)(2) Consolidated Financial Statement Schedules. | |
| Schedule II--Valuation and Qualifying Accounts for the years ended December 31, 2011, 2010 and 2009 | F-39 |
| (a)(3) List of Exhibits | |

Exhibits filed with, or incorporated by reference herein, this report are identified in the Index to Exhibits appearing in this report. The Management Agreement and the Consulting Agreement required to be filed as exhibits to this Form 10-K pursuant to Item 15(b) are noted by an asterisk (*) in the Index to Exhibits.

(b) Exhibits.

The exhibits listed on the Index to Exhibits are filed as a part of this report.

(c) Consolidated Financial Statement Schedules.

Schedule II Valuation and Qualifying Accounts for the years ended December 31, 2011, 2010 and 2009 are incorporated by reference at page F-39 of the ISA Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Dated: March 7, 2012

By : /s/ Harry Kletter

 Harry Kletter, Chairman of the Board
 and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|--|---------------|
| <u>/s/ Harry Kletter</u> Harry Kletter | Chairman of the Board and Chief Executive Officer (Principal Executive Officer) | March 7, 2012 |
| <u>/s/ Brian Donaghy</u> Brian Donaghy | President, Chief Operating Officer and Director | March 7, 2012 |
| <u>/s/ Robert Coleman</u> Robert Coleman | Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer) | March 7, 2012 |
| <u>/s/ Orson Oliver</u> Orson Oliver | Director | March 7, 2012 |
| <u>/s/ Roman Epelbaum</u> Roman Epelbaum | Director | March 7, 2012 |
| <u>/s/ Albert Cozzi</u> Albert Cozzi | Director | March 7, 2012 |
| <u>/s/ Francesca Scarito</u> Francesca Scarito | Director | March 7, 2012 |
| <u>/s/ David Russell</u> David Russell | Director | March 7, 2012 |

INDEX TO EXHIBITS

| <u>Exhibit Number</u> | <u>Description of Exhibits</u> |
|---------------------------|--|
| 3.1 | ** Certificate of Incorporation of ISA is incorporated by reference to Exhibit 3.1 of ISA's report on Form 10-KSB for the year ended December 31, 1995. |
| 3.2 | Articles of Amendment to the Articles of Incorporation of ISA, dated February 29, 2012. |
| 3.3 | Amended and Restated Bylaws of ISA, dated January 19, 2012. |
| 10.1 | ** Lease Agreement, dated January 1, 1998, by and between ISA and K&R, is incorporated by reference herein, to Exhibit 10.10 on Form 8-K of ISA, filed March 3, 1998 (File No. 0-20979).* |
| 10.2 | ** Consulting Agreement, dated as of January 2, 1998, by and between ISA and K&R, is incorporated by reference herein, to Exhibit 10.11 on Form 8-K of ISA, filed March 3, 1998 (File No. 0-20979).* |
| 10.3 | ** Promissory Note for K&R, LLC in favor of ISA in the principal amount of \$302,160, dated March 25, 2006, and effective December 31, 2005, is incorporated by reference herein to Exhibit 10.32 of ISA's report on Form 10-K for the year ended December 31, 2005, as filed on March 31, 2006. |
| 10.4 | ** Asset Purchase Agreement dated as of August 2, 2007, between ISA and Industrial Logistic Services, LLC, including exhibits thereto, is incorporated by reference herein to Exhibit 10.1 of ISA's report on Form 8-K for the event reported on August 2, 2007, as filed on August 8, 2007. |
| 10.5 | ** Executive Employment Agreement dated as of August 2, 2007, between ISA and Brian G. Donaghy is incorporated by reference herein to Exhibit 10.2 of ISA's report on Form 8-K for the event reported on August 2, 2007, as filed on August 8, 2007. |
| 10.6 | ** Employment Agreement dated effective as of April 4, 2007, between ISA and James K. Wiseman, III is incorporated by reference herein to Exhibit 10.3 of ISA's report on Form 8-K for the event reported on August 2, 2007, as filed on August 8, 2007. |
| 10.7 | ** Swap Confirmation, dated October 20, 2008, between ISA and Branch Banking and Trust Company in the notional amount of \$2,897,114.77 is incorporated by reference herein to Exhibit 10.4 of ISA's Report on Form 10-Q for the quarter ended September 30, 2008, as filed on November 5, 2008. |
| 10.8 | ** Swap Confirmation, dated October 20, 2008, between ISA and Branch Banking and Trust Company in the notional amount of \$6,000,000 is incorporated by reference herein to Exhibit 10.5 of ISA's Report on Form 10-Q for the quarter ended September 30, 2008, as filed on November 5, 2008. |
| 10.9 | ** Agreement to Purchase Real Estate, dated as of April 2, 2009, between ISA and LUCA Investments, LLC, is incorporated by reference herein to Exhibit 10.1 of ISA's report on Form 8-K for the event reported on April 2, 2009, as filed on April 7, 2009. |
| 10.10 | ** Agreement and Plan of Share Exchange, dated as of July 16, 2009, between ISA and Harry Kletter Family Limited Partnership, is incorporated by reference herein to Exhibit 10.1 of ISA's report on Form 8-K for the event reported on July 16, 2009, as filed on July 17, 2009. |
| 10.11 | ** Agreement and Plan of Share Exchange, dated as of July 16, 2009, between ISA and Harry Kletter Family Limited Partnership, is incorporated by reference herein to Exhibit 10.2 of ISA's report on Form 8-K for the event reported on July 16, 2009, as filed on July 17, 2009. |

| <u>Exhibit Number</u> | <u>Description of Exhibits</u> |
|---------------------------|--|
| 10.12 | ** Loan Agreement, dated April 13, 2010, in the amount of \$20,000,000 from ISA in favor of Branch Banking and Trust Company and BB&T Bankcard Corporation of North Carolina is incorporated by reference herein to Exhibit 10.1 of ISA's Report on Form 10-Q for the quarter ended March 31, 2010, as filed on May 10, 2010. |
| 10.13 | ** Schedule DD to BB&T Loan Agreement is incorporated by reference herein to Exhibit 10.2 of ISA's Report on Form 10-Q for the quarter ended March 31, 2010, as filed on May 10, 2010. |
| 10.14 | ** Promissory Note, dated April 13, 2010, in the amount of \$20,000,000 payable to Branch Banking and Trust Company is incorporated by reference herein to Exhibit 10.3 of ISA's Report on Form 10-Q for the quarter ended March 31, 2010, as filed on May 10, 2010. |
| 10.15 | ** Addendum to Promissory Note dated April 13, 2010 is incorporated by reference herein to Exhibit 10.4 of ISA's Report on Form 10-Q for the quarter ended March 31, 2010, as filed on May 10, 2010. |
| 10.16 | ** Modification and Cross-Collateralization Agreement, dated April 13, 2010, among ISA, ISA Real Estate, LLC, ISA Indiana Real Estate, LLC, 7021 Grade Lane, LLC and Branch Banking and Trust Company is incorporated by reference herein to Exhibit 10.5 of ISA's Report on Form 10-Q for the quarter ended March 31, 2010, as filed on May 10, 2010. |
| 10.17 | ** ISA Asset Purchase Agreement, dated July 1, 2010, by and between ISA and Venture Metals, LLC, of Florida is incorporated by reference herein to Exhibit 10.6 of ISA's Report on Form 10-Q for the quarter ended March 31, 2010, as filed on May 10, 2010. |
| 10.18 | ** Amended and Restated Executive Employment Agreement, dated April 1, 2010, by and between ISA and Brian Donaghy is incorporated by reference herein to Exhibit 10.7 of ISA's Report on Form 10-Q for the quarter ended March 31, 2010, as filed on May 10, 2010. |
| 10.19 | ** Amended and Restated Executive Employment Agreement, dated July 1, 2010, by and between ISA and Steve Jones is incorporated by reference herein to Exhibit 10.1 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |
| 10.20 | ** Amended and Restated Executive Employment Agreement, dated July 1, 2010, by and between ISA and Jeff Valentine is incorporated by reference herein to Exhibit 10.2 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |
| 10.21 | ** Amendment to the Asset Purchase Agreement of Venture Metals, LLC, dated July 1, 2010, by and between ISA and Venture Metals, LLC, of Florida is incorporated by reference herein to Exhibit 10.3 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |
| 10.22 | ** Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.4 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |
| 10.23 | ** Schedule 5.22 to Credit Agreement is incorporated by reference herein to Exhibit 10.5 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |
| 10.24 | ** Revolving Loan Note, dated July 30, 2010, in the amount of \$40,000,000 payable to Fifth Third Bank is incorporated by reference herein to Exhibit 10.6 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |
| 10.25 | ** Term Loan Note, dated July 30, 2010, in the amount of \$8,800,000 payable to Fifth Third Bank is incorporated by reference herein to Exhibit 10.7 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

| <u>Exhibit Number</u> | <u>Description of Exhibits</u> |
|-----------------------|---|
| 10.26 | ** Security Agreement, dated as of July 30, 2010, by and among Fifth Third Bank, Computerized Waste Systems, LLC, ISA Indiana Real Estate, LLC, ISA Logistics LLC, ISA Real Estate LLC, ISA Recycling, LLC, Waste Equipment Sales & Service Co., LLC, 7021 Grade Lane LLC, 7124 Grade Lane LLC, and 7200 Grade Lane LLC is incorporated by reference herein to Exhibit 10.8 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |
| 10.27 | ** Guaranty, dated as of July 30, 2010, by Computerized Waste Systems, LLC, ISA Indiana Real Estate, LLC, ISA Logistics LLC, ISA Real Estate LLC, ISA Recycling, LLC, Waste Equipment Sales & Service Co., LLC, 7021 Grade Lane LLC, 7124 Grade Lane LLC, and 7200 Grade Lane LLC is incorporated by reference herein to Exhibit 10.9 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |
| 10.28 | ** Pledge Agreement, dated as of July 30, 2010, between Industrial Services of America, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.10 of ISA's Report on Form 10-Q for the quarter ended June 30, 2010, as filed on August 9, 2010. |
| 10.29 | ** Promissory Note, dated April 12, 2011, in the amount of \$226,855 payable to Fifth Third Bank is incorporated by reference herein to Exhibit 10.1 of ISA's Report on Form 10-Q for the quarter ended March 31, 2011, as filed on May 2, 2011. |
| 10.30 | ** Loan and Security Agreement dated April 12, 2011, by and between Fifth Third Bank and Industrial Services of America, Inc. is incorporated by reference herein to Exhibit 10.2 of ISA's Report on Form 10-Q for the quarter ended March 31, 2011, as filed on May 2, 2011. |
| 10.31 | ** First Amendment to Credit Agreement, dated April 14, 2011, by and among Industrial Services of America, Inc., ISA Indiana, Inc., and Fifth Third Bank is incorporated by reference herein to Exhibit 10.3 of ISA's Report on Form 10-Q for the quarter ended March 31, 2011, as filed on May 2, 2011. |
| 10.32 | ** Reaffirmation and Amendment of Guaranty and Reaffirmation of Security, dated April 14, 2011, by and among Fifth Third Bank, ISA Indiana Real Estate, LLC, ISA Logistics LLC, ISA Real Estate, LLC, 7021 Grade Lane LLC, 7124 Grade Lane LLC, 7200 Grade Lane LLC, Computerized Waste Systems, LLC, ISA Recycling LLC, and Waste Equipment Sales & Service Co., LLC is incorporated by reference herein to Exhibit 10.4 of ISA's Report on Form 10-Q for the quarter ended March 31, 2011, as filed on May 2, 2011. |
| 10.33 | ** Amended and Restated Revolving Loan Note, dated April 14, 2011, in the amount of \$45,000,000 payable to Fifth Third Bank is incorporated by reference herein to Exhibit 10.5 of ISA's Report on Form 10-Q for the quarter ended March 31, 2011, as filed on May 2, 2011. |
| 10.34 | ** First Amendment to Credit Agreement, dated November 15, 2010 by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.1 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.35 | ** Promissory Note, dated October 13, 2010, in the amount of \$1,320,240 payable to Fifth Third Bank, and Loan and Security Agreement, dated October 13, 2010, by and between Fifth Third Bank and Industrial Services of America, Inc. is incorporated by reference herein to Exhibit 10.2 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.36 | ** Exhibit A of First Amendment to Credit Agreement, dated April 14, 2011: Amended and Restated Revolving Loan Note, dated April 14, 2011, in the amount of \$45,000,000 payable to Fifth Third Bank is incorporated by reference herein to Exhibit 10.3 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.37 | ** Schedules 1.1 through 8.11 of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.5 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |

| Exhibit Number | Description of Exhibits |
|---------------------------|---|
| 10.38 | ** Exhibit A (Advance Request and Borrowing Notice) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.6 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.39 | ** Exhibit B (Borrowing Base Certificate) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.7 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.40 | ** Exhibit C-1 (Form of Borrower Security Agreement) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.8 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.41 | ** Exhibit C-2 (Form of Guarantor Security Agreement) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.9 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.42 | ** Exhibit D (Compliance Certificate) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.10 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.43 | ** Exhibit E (Form of Pledge Agreement) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.11 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.44 | ** Exhibit F (Form of Revolving Loan Note) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.12 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.45 | ** Exhibit G (Form of Term Loan Note) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.13 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.46 | ** Exhibit H (Form of Guaranty) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.14 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.47 | ** Exhibit I (Form of Agreement Regarding Insurance) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.15 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |
| 10.48 | ** Exhibit J (Assignment and Assumption) of Credit Agreement, dated July 30, 2010, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.16 of ISA's Report on Form 10-Q for the quarter ended June 30, 2011, as filed on August 9, 2011. |

| <u>Exhibit Number</u> | <u>Description of Exhibits</u> |
|---------------------------|--|
| 10.49 | ** Loan and Security Agreement, dated August 9, 2011, by and between Industrial Services of America, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.1 of ISA's Report on Form 10-Q for the quarter ended September 30, 2011, as filed on November 14, 2011. |
| 10.50 | ** Exhibit A to the Loan and Security Agreement: Promissory Note, including Schedule A, dated August 9, 2011, in the amount of \$115,010 payable to Fifth Third Bank is incorporated by reference herein to Exhibit 10.2 of ISA's Report on Form 10-Q for the quarter ended September 30, 2011, as filed on November 14, 2011. |
| 10.51 | ** Second Amendment to Credit Agreement, dated November 15, 2011, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank is incorporated by reference herein to Exhibit 10.1 of ISA's Report on Form 8-K, as filed on December 12, 2011. |
| 10.52 | ** Amended and Restated Revolving Loan Note, dated November 15, 2011, by Industrial Services of America, Inc. and ISA Indiana, Inc. in favor of Fifth Third Bank is incorporated by reference herein to Exhibit 10.2 of ISA's Report on Form 8-K, as filed on December 12, 2011. |
| 10.53 | Second Amendment to Consulting Agreement, dated as of February 23, 2012, by and between ISA and K&R, LLC.* |
| 10.54 | Third Amendment to Credit Agreement, dated as of March 2, 2012 by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank. |
| 11 | Statement of Computation of Earnings Per Share (See Note 10 to Notes to Consolidated Financial Statements). |
| 31.1 | Rule 13a-14(a) Certification of Harry Kletter for the Form 10-K for the year ended December 31, 2011. |
| 31.2 | Rule 13a-14(a) Certification of Robert D. Coleman for the Form 10-K for the year ended December 31, 2011. |
| 32.1 | Section 1350 Certification of Harry Kletter and Robert D. Coleman for the Form 10-K for the year ended December 31, 2011. |
| 101.INS | XBRL Instance Document*** |
| 101.SCH | XBRL Taxonomy Extension Schema Document*** |
| 101.CAL | XBRL Taxonomy Extension Calculation Document*** |
| 101.DEF | XBRL Taxonomy Extension Definitions Document*** |
| 101.LAB | XBRL Taxonomy Extension Labels Document*** |
| 101.PRE | XBRL Taxonomy Extension Presentation Document*** |

*Denotes a management contract of ISA required to be filed as an exhibit pursuant to Item 601(10)(iii) of Regulation S-K under the Securities Act of 1933, as amended.

**Previously filed.

***Pursuant to Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

**INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

CONTENTS

| | |
|---|----|
| <u>REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u> | 1 |
| FINANCIAL STATEMENTS | |
| <u>CONSOLIDATED BALANCE SHEETS</u> | 2 |
| <u>CONSOLIDATED STATEMENTS OF INCOME</u> | 4 |
| <u>CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY</u> | 5 |
| <u>CONSOLIDATED STATEMENTS OF CASH FLOWS</u> | 6 |
| <u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS</u> | 7 |
| <u>SUPPLEMENTARY INFORMATION</u> | |
| <u>VALUATION AND QUALIFYING ACCOUNTS</u> | 39 |

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Industrial Services of America, Inc. and Subsidiaries
Louisville, Kentucky

We have audited the accompanying consolidated balance sheets of Industrial Services of America, Inc. and Subsidiaries as of December 31, 2011 and 2010 and the related consolidated statements of income, shareholders' equity and cash flows for each of the years in the three year period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15(a)2. The financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Industrial Services of America, Inc. and Subsidiaries as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2011, in conformity with U. S. generally accepted accounting principles. Also, in our opinion, the related consolidated financial statements schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

Mountjoy Chilton Medley LLP

Louisville, Kentucky
March 7, 2012

See accompanying notes to consolidated financial statements.

1

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2011 and 2010

| | 2011 | 2010 |
|--|------------------|-------------------|
| | (in thousands) | |
| ASSETS | | |
| Current assets | | |
| Cash | \$ 2,267 | \$ 2,468 |
| Income tax receivable | 3,967 | |
| Accounts receivable – trade (after allowance for doubtful accounts of \$100.0 thousand in 2011 and 2010) (Note 1) | 17,191 | 27,449 |
| Net investment in sales-type leases (Note 5) | 40 | 33 |
| Inventories (Note 1) | 18,544 | 34,311 |
| Deferred income taxes (Note 4) | 411 | 942 |
| Prepaid expenses | 328 | 392 |
| Employee loans | 6 | 7 |
| Total current assets | 42,754 | 65,602 |
| Net property and equipment | 26,199 | 27,554 |
| Other assets | | |
| Net investment in sales-type leases (Note 5) | | 40 |
| Notes receivable – related party (Note 6) | 45 | 88 |
| Goodwill (Note 1) | 6,840 | 6,840 |
| Intangible assets, net (Note 1) | 5,025 | 5,775 |
| Other assets | 107 | 263 |
| Total other assets | 12,017 | 13,006 |
| Total assets | \$ 80,970 | \$ 106,162 |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2011 and 2010

| | 2011 | 2010 |
|---|------------------|-------------------|
| | (in thousands) | |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities | | |
| Current maturities of long-term debt (Note 3) | \$ 1,821 | \$ 1,824 |
| Accounts payable | 10,681 | 11,406 |
| Income tax payable | | 2,909 |
| Interest rate swap agreement liability (Note 1) | 484 | 650 |
| Accrued bonuses | | 1,175 |
| Other current liabilities | 331 | 320 |
| Total current liabilities | 13,317 | 18,284 |
| Long-term liabilities | | |
| Long-term debt (Note 3) | 26,688 | 43,623 |
| Deferred income taxes (Note 4) | 3,406 | 3,373 |
| Total long-term liabilities | 30,094 | 46,996 |
| Shareholders equity | | |
| Common stock, \$0.0033 par value: 10,000,000 shares authorized, 7,192,479 and 7,192,500 shares issued in 2011 and 2010, respectively, 6,940,517 and 6,789,917 shares outstanding in 2011 and 2010, respectively | 24 | 24 |
| Additional paid-in capital | 18,131 | 17,852 |
| Retained earnings | 20,057 | 23,938 |
| Accumulated other comprehensive loss | (290) | (353) |
| Treasury stock at cost, 251,962 and 402,583 shares in 2011 and 2010, respectively | (363) | (579) |
| Total shareholders equity | 37,559 | 40,882 |
| Total liabilities and shareholders equity | \$ 80,970 | \$ 106,162 |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2011, 2010 and 2009

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|--|---|-----------------|-----------------|
| | (in thousands, except per share information) | | |
| Revenue from services | \$ 5,279 | \$ 6,212 | \$ 7,095 |
| Revenue from product sales | 271,591 | 336,793 | 173,957 |
| Total Revenue | 276,870 | 343,005 | 181,052 |
| Cost of goods sold for services | 4,716 | 5,401 | 5,514 |
| Cost of goods sold for product sales | 260,450 | 310,319 | 155,245 |
| Inventory adjustment for lower cost or market | 3,441 | | |
| Total Cost of goods sold | 268,607 | 315,720 | 160,759 |
| Selling, general and administrative expenses | 12,720 | 13,737 | 10,488 |
| (Loss) income before other income (expense) | (4,457) | 13,548 | 9,805 |
| Other income (expense) | | | |
| Interest expense | (2,025) | (1,473) | (1,096) |
| Interest income | 19 | 29 | 32 |
| Gain on sale of assets | 107 | 281 | 74 |
| Other (loss) income, net | (566) | 41 | (29) |
| Total other expense | (2,465) | (1,122) | (1,019) |
| (Loss) income before income taxes | (6,922) | 12,426 | 8,786 |
| Income tax (benefit) provision (Note 4) | (3,041) | 4,373 | 3,501 |
| Net (loss) income | \$ (3,881) | \$ 8,053 | \$ 5,285 |
| Basic (loss) earnings per share | \$ (0.56) | \$ 1.22 | \$ 0.91 |
| Diluted (loss) earnings per share | \$ (0.56) | \$ 1.21 | \$ 0.91 |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
Years ended December 31, 2011, 2010 and 2009

| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Treasury Stock | | Total |
|---|--------------|--------|----------------------------------|----------------------|---|----------------|------------|-----------|
| | Shares | Amount | | | | Shares | Cost | |
| (in thousands, except share information) | | | | | | | | |
| Balance as of January 1, 2009 | 6,442,500 | \$ 21 | \$ 3,743 | \$ 10,600 | \$ (475) | (1,079,562) | \$ (1,548) | \$ 12,341 |
| Net unrealized income on derivative instruments, net of tax | | | | | 137 | | | 137 |
| Stock bonuses | | | 37 | | | 16,500 | 23 | 60 |
| Purchase of real estate (3409 Camp Ground Road) | | | 370 | | | 300,000 | 430 | 800 |
| Purchase of real estate (7124 & 7200 Grade Lane) | 750,000 | 3 | 3,197 | | | | | 3,200 |
| Stock option distribution to Directors | | | 95 | | | | | 95 |
| Net income | | | | 5,285 | | | | 5,285 |
| Balance as of December 31, 2009 | 7,192,500 | 24 | 7,442 | 15,885 | (338) | (763,062) | (1,095) | 21,918 |
| Net unrealized loss on derivative instruments, net of tax | | | | | (15) | | | (15) |
| Stock bonuses | | | 417 | | | 60,479 | 86 | 503 |
| Purchase of intangibles | | | 2,693 | | | 300,000 | 430 | 3,123 |
| Contingent consideration | | | 7,300 | | | | | 7,300 |
| Net Income | | | | 8,053 | | | | 8,053 |
| Balance as of December 31, 2010 | 7,192,500 | 24 | 17,852 | 23,938 | (353) | (402,583) | (579) | 40,882 |
| Net unrealized income on derivative instruments, net of tax | | | | | 63 | | | 63 |
| Stock bonuses | | | 409 | | | 60,600 | 86 | 495 |
| Venture Metals, LLC - contingent consideration | | | (130) | | | 90,000 | 130 | |
| Reclass fractional shares purchased after stock split | (21) | | | | | | 21 | |

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

| | | | | | | | | |
|--|------------------|--------------|------------------|------------------|-----------------|------------------|-----------------|------------------|
| Net loss | | | | (3,881) | | | | (3,881) |
| Balance as of December 31, 2011 | <u>7,192,479</u> | <u>\$ 24</u> | <u>\$ 18,131</u> | <u>\$ 20,057</u> | <u>\$ (290)</u> | <u>(251,962)</u> | <u>\$ (363)</u> | <u>\$ 37,559</u> |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2011, 2010 and 2009

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|--|-----------------|----------------|-----------------|
| | (in thousands) | | |
| Cash flows from operating activities | | | |
| Net (loss) income | \$ (3,881) | \$ 8,053 | \$ 5,285 |
| Adjustments to reconcile net income to net cash from operating activities: | | | |
| Depreciation and amortization | 4,517 | 3,887 | 2,799 |
| Inventory write-down | 3,441 | | |
| Stock bonus to employees | 495 | 504 | 60 |
| Stock options to Directors | | | 95 |
| Deferred income taxes | 459 | (196) | 2,899 |
| Provision for doubtful accounts | | | (390) |
| Gain on sale of property and equipment | (107) | (281) | (74) |
| Change in assets and liability | | | |
| Receivables | 10,259 | (18,937) | (4,311) |
| Net investment in sales-type leases | 33 | 28 | 25 |
| Inventories | 12,325 | (7,884) | (12,946) |
| Other assets | 226 | (67) | (166) |
| Income tax receivable | (3,967) | | |
| Accounts payable | (724) | 6,721 | 982 |
| Accrued bonuses | (1,175) | (339) | 1,459 |
| Accrued legal | 7 | 29 | (988) |
| Income tax payable | (2,909) | 2,749 | (48) |
| Other current liabilities | 5 | (92) | (233) |
| | <u>19,004</u> | <u>(5,825)</u> | <u>(5,552)</u> |
| Net cash from (used in) operating activities | | | |
| Cash flows from investing activities | | | |
| Proceeds from sale of property and equipment | 183 | 376 | 111 |
| Purchases of property and equipment | (2,456) | (3,876) | (1,042) |
| Deposits on equipment | (37) | (193) | (290) |
| Payments for shredder system | | | (6,527) |
| Acquisition from Venture Metals | | | (11,875) |
| Payments from related party | 43 | 41 | 39 |
| | <u>(2,267)</u> | <u>(3,652)</u> | <u>(19,584)</u> |
| Net cash used in investing activities | | | |
| Cash flows from financing activities | | | |
| Payments on capital lease obligation | | (21) | (81) |
| Proceeds from other long-term debt | | | 1,499 |
| Net proceeds from Fifth Third Bank | 342 | 45,034 | |
| Payments on Fifth Third Bank debt | (17,280) | | |
| (Payments on) Proceeds from note payable to BB&T | | (5,000) | 5,000 |
| Payments on other BB&T debt | | (28,499) | (625) |
| Payments on other long-term debt | | (282) | (1,732) |
| Proceeds from BB&T | | | 20,684 |
| | <u>(16,938)</u> | <u>11,232</u> | <u>24,745</u> |
| Net cash (used in) from financing activities | | | |
| Net change in cash | (201) | 1,755 | (391) |
| Cash at beginning of year | 2,468 | 713 | 1,104 |

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

| | | | |
|--|-----------------|-----------------|---------------|
| Cash at end of year | <u>\$ 2,267</u> | <u>\$ 2,468</u> | <u>\$ 713</u> |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for interest | \$ 2,025 | \$ 1,473 | \$ 1,096 |
| Cash paid for taxes | 3,385 | 1,946 | 749 |
| Supplemental disclosure of noncash investing and financing activities: | | | |
| Common stock issued to acquire real estate | \$ | \$ | \$ 4,000 |
| Common stock issued to acquire intangibles | | 3,123 | |
| Contingent consideration | | 7,300 | |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010, and 2009

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business: The Recycling division of Industrial Services of America, Inc. and its subsidiaries (ISA) purchases and sells ferrous and nonferrous materials, including stainless steel, and fiber scrap on a daily basis at our two wholly owned subsidiaries, ISA Recycling, LLC (located in Louisville, Kentucky) and ISA Indiana, Inc. (serving southern Indiana). We expanded this division into the stainless steel recycling market for super alloys and high-temperature metals in 2009. 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. Through the Waste Services division (see the Segment information at Note 12), ISA also provides products and services to meet the waste management needs of its customers related to ferrous, non-ferrous and corrugated scrap recycling, management services and waste equipment sales and rental. This division represents contracts with retail, commercial and industrial businesses to handle their waste disposal needs, primarily by subcontracting with commercial waste hauling and disposal companies. Our customers and subcontractors are located throughout the United States. This division also installs or repairs equipment and rental equipment on a timely basis. Each of our segments bills separately for its products or services. Generally, services and products are not bundled for sale to individual customers. The products or services have value to the customer on a standalone basis.

Revenue Recognition: ISA records revenue for its recycling and equipment sales divisions upon delivery of the related materials and equipment to the customer. We provide installation and training on all equipment and we charge these costs to the customer, recording revenue in the period we provide the service. We are the middleman in the sale of the equipment and not a manufacturer. Any warranty is the responsibility of the manufacturer and therefore we make no estimates for warranty obligations. Allowances for equipment returns are made on a case-by-case basis. Historically, returns of equipment have not been material.

Our management services group provides our customers with evaluation, management, monitoring, auditing and cost reduction of our customers non-hazardous solid waste removal activities. We recognize revenue related to the management aspects of these services when we deliver the services. We record revenue related to this activity on a gross basis because we are ultimately responsible for service delivery, have discretion over the selection of the specific service provided and the amounts to be charged, and are directly obligated to the subcontractor for the services provided. We are an independent contractor. If we discover that third party service providers have not performed, either by auditing of the service provider invoices or communications from our customers, we then resolve the service delivery dispute directly with the third party service supplier.

We record sales-type leases at the net present value of future minimum lease payments. Interest income related to the lease is recognized over the life of the lease. At the inception of the lease, any difference between the net present value of future cash flows and the basis of the leased asset (carrying value plus initial direct costs, less present value of any residual) is recorded as a gain or

loss.

Cash and Cash Equivalents: Cash and cash equivalents includes cash in banks with original maturities of three months or less. Cash and cash equivalents are stated at cost which approximates market value, which in the opinion of management, are subject to an insignificant risk of loss in value. We maintain a cash account on deposit with BB&T which serves as collateral for our interest rate swap agreements. This compensating balance arrangement is verbal only and does not legally restrict the use of these funds. As of December 31, 2011, the balance in this account was \$653.1 thousand.

Accounts Receivable and Allowance for Doubtful Accounts: Accounts receivable consists primarily of amounts due from customers from product and brokered sales. The allowance for doubtful accounts totaled \$100.0 thousand at December 31, 2011 and December 31, 2010. Our determination of the allowance for doubtful accounts includes a number of factors, including the age of the balance, past experience with the customer account, changes in collection patterns and general economic and industry conditions. Interest is not normally charged on receivables nor do we normally require collateral for receivables. Potential credit losses from our significant customers could adversely affect our results of operations or financial condition. While we believe our allowance for doubtful accounts is adequate, changes in economic conditions or any weakness in the steel and metals industry could adversely impact our future earnings. In general, we consider accounts receivable past due 30 to 60 days after the invoice date. We charge off losses to the allowance when we deem further collection efforts will not provide additional recoveries.

Major Customer: North American Stainless (NAS) is a major customer in our Recycling segment. Sales to NAS equaled 44.4% of our consolidated revenue in 2011, and 63.7% of our consolidated revenue in 2010, and the loss of NAS would have a material adverse effect on our financial statements. The accounts receivable balance from NAS was \$8.5 million and \$13.6 million as of December 31, 2011 and 2010, respectively.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, ISA Indiana, Inc., ISA Recycling, LLC, Industrial Logistics, and ISA Alloys. Upon consolidation, all intercompany accounts, transactions and profits have been eliminated.

Common Control: We conduct significant levels of business (see Note 6) with K&R, LLC (K&R), which is owned by ISA's chief executive officer and principal shareholder. Because these entities are under common control, our operating results or our financial position may be materially different from those that would have been obtained if the entities were autonomous.

Estimates: In preparing the consolidated financial statements in conformity with generally accepted accounting principles in the United States of America, 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. Examples of estimates include the allowance for doubtful accounts, estimates associated with annual goodwill impairment tests, and estimates of deferred income tax and liabilities. The Company also uses estimates when assessing fair values of assets and liabilities acquired in business acquisitions as well as any fair value and any related impairment charges related to the carrying value of machinery and equipment, and other long-lived assets. Despite the Company's intention to establish accurate estimates and use reasonable assumptions, actual results may differ from these

estimates.

Inventories: Our inventories primarily consist of ferrous and non-ferrous, including stainless steel, scrap metals and fiber scrap and are valued at the lower of average purchased cost or market using the specific identification method. 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 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 inventory. We record the loss in cost of goods sold in the period during which we identified the loss.

We make certain assumptions regarding future demand and net realizable value in order to assess whether inventory is properly recorded at the lower of cost or market. We base our assumptions on historical experience, current market conditions and current replacement costs. If the anticipated future selling prices of scrap metal and finished steel products should decline, we would re-assess the recorded net realizable value of our inventory and make any adjustments we feel necessary in order to reduce the value of our inventory (and increase cost of goods sold) to the lower of cost or market. In the third quarter of 2011, demand and prices for inventory decreased due to reduced demand for stainless steel arising from weakening economic conditions, which led to a reduction in stainless steel sales volumes and average stainless steel selling prices. In addition, continued weak demand and the impact of declines in anticipated future selling prices which outpaced the decline in inventory costs, resulted in ISA recording a non-cash net realizable value (NRV) inventory write-down of \$3.4 million.

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 torched, sheared, shredded 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 by gross ton.

| | December 31, 2011 | | | |
|--|--------------------------|---------------------------|-----------------------------|------------------|
| | Raw Materials | Finished Goods | Processing Costs | Total |
| | (in thousands) | | | |
| Stainless steel, ferrous and non-ferrous materials | \$ 14,633 | \$ 1,409 | \$ 777 | \$ 16,819 |
| Waste equipment machinery | | 39 | | 39 |
| Other | | 63 | | 63 |
| Total inventories for sale | 14,633 | 1,511 | 777 | 16,921 |
| Replacement parts | 1,623 | | | 1,623 |
| Total inventories | \$ 16,256 | \$ 1,511 | \$ 777 | \$ 18,544 |

| | December 31, 2010 | | | |
|--|-------------------|-------------------|---------------------|-----------|
| | Raw Materials | Finished Goods | Processing Costs | Total |
| | (in thousands) | | | |
| Stainless steel, ferrous and non-ferrous materials | \$ 30,546 | \$ 1,203 | \$ 1,115 | \$ 32,864 |
| Waste equipment machinery | | 75 | | 75 |
| Other | | 59 | | 59 |
| | | | | |
| Total inventories for sale | 30,546 | 1,337 | 1,115 | 32,998 |
| Replacement parts | 1,313 | | | 1,313 |
| | | | | |
| Total inventories | \$ 31,859 | \$ 1,337 | \$ 1,115 | \$ 34,311 |

We charged \$777.4 thousand in general and administrative processing costs to cost of sales for the year ended December 31, 2011 and \$1.1 million for the year ended December 31, 2010. We charged freight expense to cost of goods sold.

On January 4, 2010, ISA elected to refine its method of valuing its inventory to the specific identification method, whereas in all prior years inventory was valued using the weighted average method. The new method was adopted 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 method provides a more accurate value of the inventory and will apply for all future periods. As the previous software did not have this tracking ability, management considers it impracticable to retrospectively apply the method for prior period comparative financial statements, as required by FASB's authoritative guidance entitled *Accounting Changes and Error Corrections*. This change in inventory valuation method did not have a significant impact on our operations or financial statements.

Inventory also includes all types of industrial waste handling equipment and machinery held for resale such as compactors, balers, and containers. Replacement parts included in Inventory are depreciated over a one-year life and are used by the Company within the one-year period as these parts wear out quickly due to the high-volume and intensity of the shredder function. Other inventory includes miscellaneous equipment, cardboard, fuel, and baling wire.

Property and Equipment: Property and equipment are stated at cost and depreciated on a straight-line basis over the estimated useful lives of the related property. Assets under capital lease obligations would be amortized over the term of the capital lease; as of December 31, 2011, we do not have any assets under capital lease obligations.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

Property and equipment, in thousands, as of December 31, 2011 and 2010 consist of the following:

| | <u>Life</u> | <u>2011</u> | <u>2010</u> |
|--|-------------|------------------|------------------|
| Land | | \$ 6,026 | \$ 5,872 |
| Equipment and vehicles | 1-10 years | 26,979 | 25,733 |
| Office equipment | 1-7 years | 2,481 | 2,313 |
| Rental equipment | 3-5 years | 5,046 | 5,133 |
| Building and leasehold improvements | 5-40 years | 8,271 | 7,733 |
| | | <u>\$ 48,803</u> | <u>\$ 46,784</u> |
| Less accumulated depreciation and amortization | | <u>22,604</u> | <u>19,230</u> |
| | | <u>\$ 26,199</u> | <u>\$ 27,554</u> |

Depreciation expense for the years ended December 31, 2011, 2010 and 2009 was \$3.8 million, \$3.5 million, and \$2.8 million, respectively. Of the \$3.8 million depreciation expense recognized in 2011, \$2.6 million was recorded in cost of sales, and \$1.2 million was recorded in general and administrative expense. Of the \$3.5 million depreciation expense recognized in 2010, \$2.8 million was recorded in cost of sales, and \$0.7 million was recorded in general and administrative expense.

A typical term of our rental equipment leases is five years. The revenue stream is based on monthly usage and recognized in the month of usage. We record purchased rental equipment, including all installation and freight charges, as a fixed asset. We are typically responsible for all repairs and maintenance expenses on rental equipment. Based on existing agreements, future operating lease revenue from rental equipment for each of the next five years, in thousands, is estimated to be:

| | |
|------|-----------------|
| 2012 | \$ 1,489 |
| 2013 | 1,017 |
| 2014 | 759 |
| 2015 | 535 |
| 2016 | 214 |
| | <u>\$ 4,014</u> |

Goodwill and Other Intangible Assets: Goodwill and certain intangible assets are no longer amortized but are assessed at least annually for impairment with any such impairment recognized in the period identified. We perform our annual goodwill impairment test internally at December 31 and at the level of the recycling reporting units to which all the goodwill is related. We determine whether to impair goodwill by comparing the fair value of the recycling reporting unit as a whole (the present value of expected cash flows) to its carrying value including goodwill. Since the recycling reporting unit's fair value exceeds its carrying value, no further computations are required. See also Note 13 Purchase of Inventory, Fixed Assets, and Intangible Assets of Venture Metals, LLC for additional information on the purchased intangibles and the goodwill valuation performed by an outside service.

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 of Financial Instruments.

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

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

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. See also Note 13 Purchase of Inventory, Fixed Assets, and Intangible Assets of Venture Metals, LLC for additional information on the purchased intangibles.

We have the following intangible assets, in thousands, as of December 31, 2011:

| | Gross Carrying Value | Accumulated Amortization | Net Carrying Value |
|------------------------------------|-------------------------------------|-------------------------------------|-----------------------------------|
| Amortized intangible assets | | | |
| Venture Metals, LLC trade name | \$ 730 | \$ (219) | \$ 511 |
| Non-compete agreements | 620 | (186) | 434 |
| Venture Metals, LLC customer list | 4,800 | (720) | 4,080 |
| Total intangible assets | \$ 6,150 | \$ (1,125) | \$ 5,025 |

We amortize the trade name and non-compete agreements using a method that reflects the pattern in which the economic benefits are consumed or otherwise used over a 5-year life as stated in the agreements. We amortize the customer list on a straight-line basis over a 10-year life as estimated by management. We incurred amortization expense related to these assets of \$750.0 thousand and \$375.0 thousand for the years ended December 31, 2011 and 2010, respectively. We did not incur any amortization expense for the year ended December 31, 2009.

As of December 31, 2011, we expect amortization expense, in thousands, for these assets for the next five fiscal years and thereafter to be as follows:

| Year | Balance - Beginning of Year | Amortization | Balance - End of Year |
|-------------|--|---------------------|----------------------------------|
| 2012 | \$ 5,025 | \$ (750) | \$ 4,275 |
| 2013 | 4,275 | (750) | 3,525 |
| 2014 | 3,525 | (750) | 2,775 |
| 2015 | 2,775 | (615) | 2,160 |
| 2016 | 2,160 | (480) | 1,680 |
| Thereafter | 1,680 | (1,680) | |

Derivative and Hedging Activities: The FASB's authoritative guidance titled Accounting for Derivative Instruments and Hedging Activities, and subsequent amendments (hereinafter collectively referred to as FASB's guidance), contain numerous requirements including the recognition of derivative instruments in the financial statements at fair value. Derivatives that are not hedges must be adjusted to fair value through the statement of operations. If the derivative meets the requirements for hedge accounting in accordance with FASB's guidance, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

corresponding change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income (loss) until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in the statement of operations. We include the required disclosures in Note 3 Notes Payable to Bank of our Notes to Consolidated Financial Statements.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in the statement of operations.

Beginning in October, 2008, we began to utilize derivative instruments in the form of interest rate swaps to assist in managing our interest rate risk. We do not enter into any interest rate swap derivative instruments for trading purposes. We recognize as an adjustment to interest expense the differential paid or received on interest rate swaps. We include in other comprehensive income the change in the fair value of the interest rate swap, which is established as an effective hedge.

Advertising Expense: Advertising costs are charged to expense in the period the costs are incurred. Advertising expense was \$83.8 thousand, \$218.9 thousand, and \$237.8 thousand for the years ended December 31, 2011, 2010, and 2009, respectively.

Accumulated Other Comprehensive Income (Loss): Comprehensive income is net income plus certain other items that are recorded directly to shareholders' equity. Amounts included in other accumulated comprehensive loss for our derivative instruments are recorded net of the related income tax effects. The following table gives further detail regarding the composition of other accumulated comprehensive income (loss), in thousands, at December 31, 2011 and 2010.

| | |
|--|----------------------------|
| Total accumulated other comprehensive loss as of 1/1/10 | \$ (338) |
| Net unrealized loss on derivative instruments, net of tax, during 2010 | (15) |
| | <hr style="width: 100%;"/> |
| Total accumulated other comprehensive loss as of 12/31/10 | (353) |
| Net unrealized gain on derivative instruments, net of tax, during 2011 | 63 |
| | <hr style="width: 100%;"/> |
| Total accumulated other comprehensive loss as of 12/31/11 | \$ (290) |
| | <hr style="width: 100%;"/> |

Income Taxes: Deferred income taxes are recorded to recognize the tax consequences on future years of differences between the tax basis of assets and liabilities and their carrying amounts for financial reporting purposes, referred to as temporary differences, and for net operating loss carryforwards subject to an ongoing assessment of realizability. Deferred income taxes are measured by applying current tax laws.

The FASB has issued guidance, included in the ASC, related to the accounting for uncertainty in taxes recognized in financial statements. These new standards are effective for annual financial statements for fiscal years beginning after December 15, 2008. The company evaluates its uncertain tax positions and a loss contingency is recognized when it is probable that a liability has been incurred as of the date of the financial statements and the amount of the loss can be reasonably estimated. The amount recognized is subject to estimate and management's judgment.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

with respect to the likely outcome for each uncertain tax position. The amount that is ultimately sustained for an individual uncertain tax position or for all uncertain tax positions in the aggregate could differ from the amount recognized. The Company has no uncertain tax positions as of December 31, 2011, 2010, or 2009.

The Company recognizes interest accrued related to unrecognized tax positions in interest expense and penalties in operating expenses, if appropriate. The tax year 2010 remains open to examination by the Internal Revenue Service and certain state taxing jurisdictions to which the Company is subject. The tax years 2008 and 2009 have been examined.

Statement of Cash Flows: The statement of cash flows has been prepared using a definition of cash that includes deposits with original maturities of three months or less. We have reclassified certain cash flow items within the accompanying Consolidated Statements of Cash Flows and Notes to the Financial Statements for prior years in order to be comparable with the current presentation. These reclassifications had no effect on previously reported income.

Earnings Per Share: Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the year. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding plus the dilutive effect of stock options.

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|---|--|-------------|-------------|
| | (in thousands, except per share information) | | |
| <u>Net (loss) income</u> | | | |
| Net (loss) income, as reported | \$ (3,881) | \$ 8,053 | \$ 5,285 |
| <u>Basic (loss) earnings per share</u> | | | |
| As reported | \$ (0.56) | \$ 1.22 | \$ 0.91 |
| <u>Diluted (loss) earnings per share</u> | | | |
| As reported | \$ (0.56) | \$ 1.21 | \$ 0.91 |

Stock Option Plans: We have an employee stock option plan under which we may grant options for up to 2,400,000 shares of common stock, which are reserved by the board of directors for issuance of stock options. The exercise price of each option is equal to the market price of our stock on the date of grant. The maximum term of the option is five years.

We accounted for this plan based on FASB's authoritative guidance entitled *Share-Based Payment*, using the modified prospective method. The impact of accounting for this plan under this guidance on our consolidated results of operations depends on the level of future option grants and the fair value of the options granted at such future dates, as well as the vesting periods provided by such awards. Existing outstanding options did not result in additional compensation expense upon adoption of this guidance since all outstanding options were fully vested. See also Note 14 Long Term Incentive Plan in these Notes to Consolidated Financial Statements for

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

additional information regarding the Long Term Incentive Plan.

Following is a summary of stock option activity and number of shares reserved for outstanding options for the years ended December 31, 2011, 2010 and 2009:

| | Number of Shares | Weighted Average Exercise Price Per Share | Exercise Price Per Share | Maximum Remaining Term of Options Granted | Weighted Average Grant Date Fair Value of Options |
|--|---------------------|--|--------------------------------|---|---|
| Balance as of January 1, 2009 | | | | | |
| Granted | 90,000 | \$ 4.23 | \$ 4.23 | 2.5 Years | \$ 1.05 |
| Balance as of December 31, 2009 | | | | | |
| Granted | | | | | |
| Balance as of December 31, 2010 | | | | | |
| Granted | | | | | |
| Balance as of December 31, 2011 | | | | | |

On January 6, 2010, the Board of Directors granted non-performance based stock awards of 25,500 shares to management at \$6.39 per share. On January 11, 2010, we issued 18,000 shares and on February 11, 2010, we issued the remaining 7,500 shares of this grant. On June 8, 2010, we issued 30,000 shares of our stock granted on April 14, 2009 to management at a grant date fair value of \$2.53 per share. On November 15, 2010, we issued 5,000 shares of our stock to management at \$10.34 per share. In January 2011, we issued 60,000 shares of our stock granted on April 1, 2010 to management at a grant date fair value of \$11.93 per share and 600 shares of our stock to consultants at \$12.28 per share.

Fair Value of Financial Instruments: We estimate the fair value of our financial instruments using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, prepayments and other factors. Changes in assumptions or market conditions could significantly affect these estimates. As of December 31, 2011, the estimated fair value of our financial instruments approximated book value. The fair value of our debt approximates its carrying value because the majority of our debt bears a floating rate of interest based on the LIBOR rate. There is no readily available market by which to determine fair market value of our fixed term debt; however, based on existing interest rates and prevailing rates as of each year end, we have determined that the fair value of our fixed rate debt approximates book 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 assets, such as goodwill and other long-lived assets, at fair value on a non-recurring basis to evaluate those assets for potential impairment.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

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 applicable accounting standards, 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 financial instruments, in thousands, at December 31, 2011 and December 31, 2010:

| 2011: | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|---------------------------|----------------|----------------|----------------|--------------|
| Assets: | | | | |
| Cash and cash equivalents | \$ 2,267 | \$ | \$ | \$ 2,267 |
| Goodwill | | | 6,840 | 6,840 |
| Net intangible assets | | | 5,025 | 5,025 |
| Liabilities | | | | |
| Long term debt | \$ | \$ (28,509) | \$ | \$ (28,509) |
| Derivative contract | | (484) | | (484) |
| 2010: | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
| Assets: | | | | |
| Cash and cash equivalents | \$ 2,468 | \$ | \$ | \$ 2,468 |
| Goodwill | | | 6,840 | 6,840 |
| Net intangible assets | | | 5,775 | 5,775 |
| Liabilities | | | | |
| Long term debt | \$ | \$ (45,447) | \$ | \$ (45,447) |
| Derivative contract | | (650) | | (650) |

We have had no transfers in or out of Levels 1 or 2 fair value measurements. Other than standard amortization of intangible assets, we have had no activity in Level 3 fair value measurements for the year ending December 31, 2011. For Level 3 assets, goodwill of \$6.8 million is 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. No impairment was recorded as of December 31, 2011, as determined by a third party evaluation. See also Note 13 Purchase of Inventory, Fixed Assets, and Intangible Assets of Venture Metals, LLC for additional information on the third party valuation.

Subsequent Events: We have evaluated the period from December 31, 2011 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 events:

Second Amendment to Consulting Agreement with K&R, LLC:

Effective January 1, 2012, the Company and K&R, LLC entered into a Second Amendment to Consulting Agreement (the Second Amendment), which amends an April 1, 2010 amendment (the Amendment) to a consulting agreement which the parties had entered into effective January 2, 1998 (the Prior Agreement). Under the Prior Agreement, the Company engaged K&R as a consultant and retained the services of K&R management personnel to perform planning and consulting services with respect to the Company's businesses, including the preparation of business plans, pro forma budgets, and assistance with general operational issues. The Amendment increased the consulting fees from \$240.0 thousand per annum to \$480.0 thousand per annum. The Second Amendment reduces the consulting fees from \$480.0 thousand per annum to \$240.0 thousand per annum. The annual fee is payable in equal monthly installments of \$20.0 thousand. The Second Amendment otherwise ratifies the Prior Agreement in all respects. See also Note 6 Related Party Transactions for additional information relating to the Prior Agreement and the Second Amendment.

Third Amendment to Credit Agreement with Fifth Third Bank:

On March 2, 2012, Industrial Services of America, Inc. and ISA Indiana, Inc. (the Companies) entered into a Third Amendment to Credit Agreement (the Third Amendment) with Fifth Third Bank (the Bank) which amended the July 30, 2010 Credit Agreement, including the First Amendment to Credit Agreement dated as of April 14, 2011 and the Second Amendment to Credit Agreement dated as of November 16, 2011, as follows. The Third Amendment redefines the calculation period for the purpose of measuring compliance with our covenants to maintain a ratio of debt to adjusted EBITDA (the Senior Leverage Ratio) and a ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled payment of principal of not more than 1.20 to 1 (the Fixed Charge Coverage Ratio) such that each ratio will be calculated quarterly for the period beginning January 1, 2012 through the end of each quarter of 2012. Prior to the Third Amendment, the ratios were calculated on a rolling 12 month basis. The Third Amendment also changed the Senior Leverage Ratio from 3.5 to 1 in the original Credit Agreement to (i) 4.25 to 1 in the first quarter of 2012, (ii) 3.50 to 1 in the second and third quarter of 2012, and (iii) 3.25 to 1 in the fourth quarter of 2012 and thereafter. The Third Amendment also increased the unused line fee by 0.25% to 0.75% and provided a waiver of the Senior Leverage Ratio and Fixed Charge Coverage Ratio covenant defaults for the quarter ending December 31, 2011. In addition, the Companies also agreed to perform other customary commitments and pay a fee of \$10.0 thousand to the Bank. See Note 3 Notes Payable to Bank for additional details relating to this amendment.

Amendment of Articles of Incorporation:

On February 29, 2012, the Company amended its Articles of Incorporation to change the par value of its common stock to \$0.0033 per share.

Impact of Recently Issued Accounting Standards: In September 2011, the FASB issued ASU No. 2011-08, an amendment to Topic 350, Intangibles—Goodwill and Other, which simplifies how entities test goodwill for impairment. Previous guidance under Topic 350 required an entity to test goodwill for impairment using a two-step process on at least an annual basis. First, the fair value of a reporting unit was calculated and compared to its carrying amount, including goodwill. Second, if the fair value of a reporting unit was less than its carrying amount, the amount of impairment loss, if any, was required to be measured. Under the amendments in this update, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads the entity to determine that it is more likely than not that its fair value is less than its carrying amount. If after assessing the totality of events or circumstances, an entity determines that it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then the two-step impairment test is unnecessary. If the entity concludes otherwise, then it is required to

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

test goodwill for impairment under the two-step process as described under paragraphs 350-20-35-4 and 350-20-35-9 under Topic 350. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, the quarter ending March 31, 2012 for us, and early adoption is permitted. We do not expect the adoption of ASU 2011-08 will have a material impact on our Condensed Consolidated Financial Statements.

In June 2011, the FASB issued ASU 2011-05, which is an update to Topic 220, *Comprehensive Income*. This update eliminates the option of presenting the components of other comprehensive income as part of the statement of changes in stockholders' equity, requires consecutive presentation of the statement of net income and other comprehensive income and requires reclassification adjustments from other comprehensive income to net income to be shown on the financial statements. ASU 2011-05 is effective for all interim and annual reporting periods beginning after December 15, 2011, the quarter ending March 31, 2012 for us. However, ASU 2011-12 has deferred the specific requirement within ASU 2011-05 to present on the face of the financial statements items that are reclassified from accumulated other comprehensive income to net income separately with their respective components of net income and other comprehensive income. Entities should continue to report reclassifications out of accumulated comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. We do not expect a material impact on our financials due to the implementation of this guidance. As ASU No. 2011-05 relates only to the presentation of Comprehensive Income, the Company does not expect the adoption of this update will have a material effect on its consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, which is an update to Topic 820, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS)*. The amendments in this ASU generally represent clarification of Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and IFRS. The amendments are effective for interim and annual periods beginning after December 15, 2011, the quarter ending March 31, 2012 for us, and are to be applied prospectively. Early application is not permitted. We do not expect the adoption of ASU 2011-04 will have a material impact on our Condensed Consolidated Financial Statements.

NOTE 2 STOCK DIVIDEND

On May 3, 2010, the Board of Directors declared a 3-for-2 stock split effected by a 50% stock dividend. The stock dividend was issued to holders of record as of May 17, 2010, and paid June 1, 2010. All share prices in these Notes have been adjusted to reflect the impact of this stock split.

NOTE 3 - NOTES PAYABLE TO BANK

On March 2, 2012, Industrial Services of America, Inc. and ISA Indiana, Inc. (the *Companies*) entered into a Third Amendment to Credit Agreement (the *Third Amendment*) with Fifth Third Bank (the *Bank*) which amended the July 30, 2010 Credit Agreement (the *Credit Agreement*), including the First Amendment to Credit Agreement dated as of April 14, 2011 (the *April Amendment*) and the Second Amendment to Credit Agreement dated as of November 16, 2011 (the *November Amendment*), as follows. The Third Amendment redefines the calculation period for the purpose of measuring compliance with our covenant to maintain a ratio of debt to adjusted EBITDA (the *Senior Leverage Ratio*) and a ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled payment of principal of not more than 1.20 to 1 (the *Fixed Charge Coverage Ratio*) such that each ratio will be calculated quarterly for the period beginning January 1, 2012 through the end of each quarter of 2012. Prior to the Third Amendment, the ratios were calculated on a rolling 12 month basis. The Third Amendment also changed the Senior Leverage Ratio from 3.5 to 1 in the original Credit Agreement to (i) 4.25 to 1 in the first quarter of 2012, (ii) 3.50 to 1 in the second and third quarter of 2012, and (iii) 3.25 to 1 in the fourth quarter of 2012 and thereafter. The Third Amendment also increased the unused line fee by 0.25% to 0.75% and provided a waiver of the Senior Leverage Ratio and Fixed Charge Coverage Ratio covenant defaults for the quarter ending December 31, 2011, as discussed below. In addition, the Companies also agreed to perform other customary commitments and pay a fee of \$10.0 thousand to the Bank.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

On April 14, 2011, we entered into the April Amendment with the Bank which amends the Credit Agreement as follows: The April Amendment (i) increased the maximum revolving commitment and the maximum amount of eligible inventory advances in the calculation of the borrowing base, (ii) changed the due date of the first excess cash flow payment to April 30, 2012, and (iii) amended certain other provisions of the Credit Agreement and certain of the other loan documents.

On December 6, 2011, we entered into the November Amendment with the Bank which amends the Credit Agreement, as amended by the April Amendment described above. Under the April Amendment, the Company was permitted to borrow the lesser of \$45.0 million (the Maximum Revolving Commitment) or the borrowing base, consisting of the sum of 85% of eligible accounts plus 60% of eligible inventory up to \$18.0 million. Under the November Amendment, the Maximum Revolving Commitment was reduced to \$40.0 million. In addition, the Company agreed to perform other customary commitments.

Under the original Credit Agreement, we were permitted to borrow via a revolving credit facility the lesser of \$40.0 million or the borrowing base, consisting of the sum of 85% of eligible accounts plus 60% of eligible inventory up to \$17.0 million. 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 the 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 an \$8.8 million term loan, entered into to replace several notes payable with another bank. Proceeds of the original revolving credit facility in the amount of \$33.4 million were used to repay the outstanding principal balance of the prior obligations with another bank. 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.

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. As of December 31, 2011, the interest rate was 3.125%. We also paid a fee of 0.50% on the unused portion. The revolving credit facility expires on July 31, 2013. As of December 31, 2011, the outstanding balance on the revolving line of credit was \$20.1 million.

The \$8.8 million 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 \$105.0 thousand. The first such payment commenced September 1, 2010 and the final payment of the then-unpaid balance becomes due and payable in full on July 31, 2013. In addition, beginning April 30, 2012 (or, if earlier, upon completion of the Company's financial statements for the fiscal year ending December 31, 2011), 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

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

thereon. As security for the term loan, we provided the Bank a first priority security interest in all equipment other than the rental fleet that we own. As of December 31, 2011, the outstanding balance on the term loan was \$7.0 million.

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 the Bank.

In our Credit Agreement with the Bank, 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 \$4.0 million in any fiscal year. As of December 31, 2011, we were not in compliance with the covenants in (i) and (ii) above due to decreased sales relating to decreased demand in stainless steel in the last three quarters of the year. As of December 31, 2011, our ratio of debt to adjusted EBITDA was 9.31; our ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled principal payments was (0.70), and our capital expenditures totaled \$2.5 million, which includes \$36.6 thousand in deposits on equipment. In connection with the Third Amendment, we received a waiver from the Bank for the year ending December 31, 2011 for failing to meet the ratio requirements for covenants (i) and (ii) above. Pursuant to the Third Amendment, the Senior Leverage Ratio will increase to 4.25 to 1 for the period ending March 31, 2012. The Senior Leverage Ratio will then decrease to 3.5 to 1 for the periods ending June 30 and September 30, 2012 and decrease to 3.25 to 1 for the period ending December 31, 2012 and thereafter. The other covenants will remain the same going forward. As of December 31, 2011, we have \$19.9 million under our existing credit facilities that we can use based on the bank waiver received.

On April 12, 2011, we entered into a Loan and Security Agreement with Fifth Third Bank (the "Bank") pursuant to which the Bank agreed to provide the Company with a Promissory Note (the "Note") in the amount of \$226.9 thousand for the purpose of purchasing operating equipment. The interest rate is five and 68/100 percent (5.68%). Principal and interest is payable in 48 equal monthly installments of \$5.3 thousand, each due on the 20th day of each calendar month. Payment commenced on the 20th day of May, 2011, and the entire unpaid principal amount, together with all accrued and unpaid interest, charges, fees or other advances, if any, comes due on or before April 20, 2015. As security for the Note, we have granted the Bank a first priority security interest in the equipment purchased with the proceeds of the Note. As of December 31, 2011, the outstanding balance of this loan was \$187.1 thousand.

On August 9, 2011, we entered into a Loan and Security Agreement (the "August Agreement") with the Bank pursuant to which the Bank agreed to loan the Company funds pursuant to a Promissory Note (the "August Note") in the amount of \$115.0 thousand for the purpose of purchasing operating equipment. The interest rate is 5.95%. Principal and interest is payable in 48 equal monthly installments of \$2.7 thousand. The first such payment commenced on September 12, 2011, and the entire unpaid principal amount, together with all accrued and unpaid interest, charges, fees or other advances, if any, becomes due no later than August 12, 2015. As security for the August Note, we have granted the Bank a first priority security interest in the equipment purchased with the proceeds of the Note. As of December 31, 2011, the outstanding balance of this loan was \$106.4 thousand.

On October 19, 2010, we entered into a Promissory Note (the "October Note") with the Bank in the amount of \$1.3 million for the purpose of purchasing equipment. The interest rate is equal to five and 20/100 percent (5.20%) per annum. Principal and interest is payable monthly in consecutive equal installments of \$30.5 thousand 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 October Note, we provided Fifth Third Bank a first priority security interest in the equipment purchased with the proceeds. As of December 31, 2011, the outstanding balance on the Note was \$962.4 thousand.

On August 2, 2007, we entered into an asset purchase agreement for \$1.3 million funded primarily by a note payable to ILS, the sole member of which is Brian Donaghy, our president and chief operating officer, whereby we pay \$20.0 thousand per month for 60 months for various assets including tractor trailers, trucks and containers. The note payable reflects a seven percent (7.0%) interest payment on the outstanding balance plus principal amortization. We also paid ILS \$100.0

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

thousand cash as a portion of the purchase price at the time of execution of the asset purchase agreement. We recorded a note payable of \$1.0 million with an outstanding balance at December 31, 2011 of \$155.9 thousand.

We entered into three interest rate swap agreements swapping variable rates for fixed rates. The first swap agreement covers approximately \$4.7 million in debt and commenced April 7, 2009 and matures on April 7, 2014. The second swap agreement covers approximately \$2.1 million in debt and commenced October 15, 2008 and matures on May 7, 2013. The third swap agreement covers approximately \$457.5 thousand 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 December 31, 2011, we recorded the estimated fair value of the liability related to the three swaps at approximately \$484.2 thousand. 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 the Bank. We maintain a cash account on deposit with BB&T which serves as collateral for the swap agreements. See Note 1 Summary of Significant Accounting Policies Derivative and Hedging Activities for additional information about these derivative instruments.

The following table outlines the notional amounts, in thousands, related to the interest rate swaps as of December 31, 2011:

| | Notional Amount | Rate |
|--|----------------------------|-------------|
| | \$ 4,730 | 5.89% |
| | \$ 2,099 | 5.65% |
| | \$ 457 | 5.89% |

21

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

Our long term debt as of December 31, 2011 and December 31, 2010 consisted of the following:

| | <u>2011</u> | <u>2010</u> |
|--|------------------|------------------|
| | (in thousands) | |
| Revolving credit facility of \$40.0 million with Fifth Third Bank. See above description for additional details. | \$ 20,083 | \$ 35,489 |
| Note payable to Fifth Third Bank in 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. | 7,015 | 8,275 |
| Note payable to Fifth Third Bank in the amount of \$1.3 million secured by equipment purchased with the proceeds. See above description for additional details. | 962 | 1,271 |
| Loan and Security Agreement payable to Fifth Third Bank in the amount of \$227 thousand secured by the equipment purchased with the proceeds. See above description for additional details. | 187 | |
| Note payable to Fifth Third Bank in the amount of \$115 thousand secured by the equipment purchased with the proceeds. See above description for additional details. | 106 | |
| Note payable to Paccar Financial Corp. in the amount of \$164 thousand 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. | | 36 |
| 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 (7.0%) interest rate. The maturity date under this agreement is August 2012. | 156 | 376 |
| | <u>28,509</u> | <u>45,447</u> |
| Less current maturities | <u>1,821</u> | <u>1,824</u> |
| | <u>\$ 26,688</u> | <u>\$ 43,623</u> |

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

The annual maturities of long term debt, in thousands, as of December 31, 2011 are as follows:

| | |
|------------|-----------|
| 2012 | \$ 1,821 |
| 2013 | 26,264 |
| 2014 | 388 |
| 2015 | 36 |
| Thereafter | |
| | |
| Total | \$ 28,509 |
| | |

NOTE 4 - INCOME TAXES

The income tax provision (benefit), in thousands, consists of the following for the years ended December 31, 2011, 2010 and 2009:

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|--------------------------------------|-------------|-------------|-------------|
| Federal | | | |
| Current | \$ (3,373) | \$ 3,556 | \$ 364 |
| Deferred | 436 | 54 | 2,563 |
| IRS Audit Adjustment | 622 | | |
| | (2,315) | 3,610 | 2,927 |
| State | | | |
| Current | (818) | 884 | 466 |
| Refundable state recycle tax credits | | (185) | |
| Deferred | 92 | 64 | 108 |
| | (726) | 763 | 574 |
| | \$ (3,041) | \$ 4,373 | \$ 3,501 |

A reconciliation of income taxes at the statutory rate to the reported provision, in thousands, is as follows:

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|--|-------------|-------------|-------------|
| Federal income tax at statutory rate | \$ (2,468) | \$ 4,225 | \$ 2,987 |
| State and local income taxes, net of federal income tax effect | (395) | 599 | 398 |
| Permanent differences | 13 | (156) | 7 |
| Other differences | (191) | (295) | 109 |
| | \$ (3,041) | \$ 4,373 | \$ 3,501 |
| | | | |

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

Significant components of the Company's deferred tax liabilities and assets, in thousands, as of December 31, 2011 and 2010 are as follows:

| | <u>2011</u> | <u>2010</u> |
|-------------------------------------|-------------------|-------------------|
| Deferred tax liabilities | | |
| Tax depreciation in excess of book | \$ (3,505) | \$ (3,402) |
| Tax amortization in excess of book | (212) | (310) |
| | <u>(3,717)</u> | <u>(3,712)</u> |
| Deferred tax assets | | |
| Property taxes | 12 | 43 |
| Allowance for doubtful accounts | 43 | 43 |
| Book amortization in excess of tax | 29 | 58 |
| Inventory capitalization | 217 | 250 |
| Reserve for CWS | 129 | 129 |
| Bonuses | | 466 |
| Interest rate swap | 194 | 280 |
| Other | 98 | 12 |
| | <u>722</u> | <u>1,281</u> |
| Gross deferred tax assets | | |
| | <u>722</u> | <u>1,281</u> |
| Net deferred tax liabilities | \$ (2,995) | \$ (2,431) |

The Internal Revenue Service has conducted an examination of the Company's 2009 income tax return and, per the final report, has proposed changes amounting to approximately \$735.0 thousand of additional taxes due for which we expect to receive an invoice early in 2012. This increase arose from the Company's use of bonus depreciation rules for certain additions to shredding equipment which were determined to be disqualified for bonus depreciation. This additional income tax has been accrued as of December 31, 2011.

This resulting adjustment to 2009 depreciation deductions allowed the Company to file an amended U.S. tax return for 2010, pursuant to which we claim additional depreciation deductions and resulted in a claim for refund of income taxes paid amounting to approximately \$113.0 thousand which has also been accrued at December 31, 2011.

We use the deferral method of accounting for the available state tax credits relating to the purchase of the shredder equipment. On December 31, 2010, we had deferred recycling equipment state tax credit carryforwards of \$4.2 million relating to this purchase which do not expire. This tax credit is limited to 25 percent of our state income tax liability. Due to the net loss in 2011, there was no available state tax credit in 2011. We used the available credit of \$185.1 thousand in 2010.

NOTE 5 - SALES-TYPE LEASES

The Company is the lessor of equipment under sales-type lease agreements having terms of three years, with the lessees having the option to acquire the equipment at the termination of the leases. All costs associated with this equipment are the responsibility of the lessees.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

Future lease payments receivable under sales-type leases, in thousands, at December 31, 2011 are as follows:

| | |
|-------------------------------------|----------|
| 2012 | \$ 44 |
| Thereafter | _____ |
| Minimum lease payments receivable | 44 |
| Less unearned income | (4) |
| | _____ |
| Net investment in sales-type leases | 40 |
| Less current portion | (40) |
| | _____ |
| | \$ _____ |
| | _____ |

NOTE 6 - RELATED PARTY TRANSACTIONS

The Company enters into various transactions with related parties including the Company's principal shareholder and an affiliated company owned by the Company's principal shareholder (K&R). A summary of these transactions, in thousands, is as follows:

| | 2011 | 2010 | 2009 |
|---|----------|----------|----------|
| | _____ | _____ | _____ |
| <u>Balance sheet accounts:</u> | | | |
| Notes receivable | \$ 45.4 | \$ 88.4 | \$ 129.1 |
| | _____ | _____ | _____ |
| Deposits (included in other long-term assets) | \$ 62.1 | \$ 62.1 | \$ 62.1 |
| | _____ | _____ | _____ |
| <u>Income statement activity:</u> | | | |
| Rent expense (property) | \$ 582.0 | \$ 582.0 | \$ 582.0 |
| | _____ | _____ | _____ |
| Lease expense (equipment) | \$ 101.0 | \$ 5.5 | \$ _____ |
| | _____ | _____ | _____ |
| Consulting fees | \$ 480.0 | \$ 420.0 | \$ 240.0 |
| | _____ | _____ | _____ |

ISA leases its corporate offices, processing property and buildings in Louisville, Kentucky for \$48.5 thousand per month from K&R pursuant to the K&R Lease. Deposits include one month of the original lease agreement's rent in advance in the amount of \$42.1 thousand. In 2004, we paid for repairs totaling \$302.2 thousand that we made to the buildings and property that we lease from K&R, located at 7100 Grade Lane, Louisville, Kentucky. K&R executed an unsecured promissory note, dated March 25, 2005, but effective December 31, 2004, to us for the principal sum of \$302.2 thousand. In January 2006, K&R began making payments on the promissory note of principal only in ninety-six (96) monthly installments of \$3.1 thousand each. Failure of K&R to make any payment when due under this note within fifteen (15) days of its due date shall constitute a default. After the fifteen day period, the note shall bear interest at a rate equal to fifteen percent (15.0%) per annum and we have the right to exercise our remedies to collect full payment of the note.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

In an addendum to the K&R lease as of January 1, 2006, the rent was increased \$4.0 thousand as a result of the improvements made to the property in 2004. For years 2011, 2010, and 2009, the payments to K&R by the Company of \$4.0 thousand for additional rent and the payment from K&R to the Company of \$3.9 thousand for the promissory note were offset.

Effective January 1, 2012, the Company and K&R entered into an agreement (the *Second Amendment*) which amends an April 1, 2010 amendment (the *Amendment*) to a consulting agreement which the parties had entered into effective January 2, 1998 (the *Prior Agreement*). Under the *Prior Agreement*, the Company engaged K&R as a consultant and retained the services of K&R management personnel to perform planning and consulting services with respect to the Company's businesses, including the preparation of business plans, pro forma budgets, and assistance with general operational issues. The *Prior Agreement* provided for a term of ten years, with an automatic renewal for additional terms of one year on January 1 of each successive calendar year unless either party provides the other party with written notice of its intent not to renew at least six months prior to the expiration of the then existing term. The Company's Chief Executive Officer, Harry Kletter, is a member of Kletter Holding, LLC, which is the sole member of K&R. The *Amendment* increased the consulting fees from \$240.0 thousand per annum to \$480.0 thousand per annum. The *Second Amendment* reduces the consulting fees from \$480.0 thousand per annum to \$240.0 thousand per annum. The annual fee is payable in equal monthly installments of \$20.0 thousand. The *Second Amendment* otherwise ratifies the *Prior Agreement* in all respects. Deposits include one month of the original agreement's consulting services in advance in the amount of \$20.0 thousand. Our Chairman is compensated through these consulting fees. In 2011, we extended this consulting agreement for one year according to the terms of the contract.

Effective December 1, 2010, the Company and K&R entered into a lease agreement, under which the Company leases equipment from K&R for a monthly payment of \$5.5 thousand for 5 years.

Effective June 1, 2011, the Company and K&R entered into a lease agreement, under which the Company leases equipment from K&R for a monthly payment of \$5.0 thousand for 5 years.

Other related-party transactions are as follows:

Amendment to Brian Donaghy's employment agreement: Effective April 1, 2010, the Company amended and restated the employment agreement of Brian Donaghy (*Mr. Donaghy*), the Company's President and Chief Operating Officer, to (a) extend the term to June 30, 2015, and (b) provide for (i) an annual bonus based on the Company's achievement of certain return on net asset (*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. Donaghy, (ii) a bonus of up to 15,000 shares of Common Stock per annum based on the Company's achievement of certain *RONA* targets, and (iii) 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 measured on December 31, 2014.

Purchase of Venture Metals, LLC Intangibles: On March 26, 2010, we entered into an agreement dated July 1, 2010, subject to shareholder approval of certain issuances of shares of our common stock. After shareholder approval of the issuance of 300,000 shares of our common stock, on July 1, 2010, we entered into an asset purchase agreement and a non-compete agreement with Venture Metals, LLC (*Venture*), 3409 Camp Ground Road, Louisville, KY 40211. Pursuant to the asset purchase agreement dated July 1, 2010, in consideration for the transfer of the *Venture* name and entry into the Non-Compete Agreement, we delivered to *Venture* 300,000 shares of our common stock based on a price of

\$10.41 per share (the Purchase Price) based on the stock price on July 1, 2010.

The purchase price was negotiated between us and Steve Jones, former co-owner of Venture. Venture was owned by Steve Jones and Jeff Valentine, both of whom were our employees at the time. At the same time as these negotiations took place, we renegotiated all management contracts and employment agreements, including those of Mr. Jones and Mr. Valentine. Mr. Jones and Mr. Valentine's original employment agreements were entered into in connection with our prior purchase of assets from Venture. An outside financial consultant also assessed the transaction to provide an opinion of the fair value of the transaction, which led to a supplemental acquisition dated July 1, 2010, as described below.

On June 16, 2010, the Company and Venture agreed to a supplemental acquisition dated effective July 1, 2010. Pursuant to an understanding memorialized by this agreement, on April 12, 2010, the Company paid Venture \$1.3 million 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 agreed to deliver up to an additional 750,000 shares of ISA Common Stock in accordance with certain terms.

The Company obtained a valuation of Venture's intangible assets from an outside source. Based on preliminary estimates, we recorded additional goodwill of \$4.3 million and decreased the intangible asset by \$630.0 thousand as of December 31, 2010. No changes were made to recorded amounts for goodwill or the other amortized intangible items based on this valuation, which was finalized in the second quarter of 2011. Based on a third party review, no impairment was recorded to goodwill as of December 31, 2011.

See Note 13 Purchase of Inventory, Fixed Assets, and Intangibles of Venture Metals, LLC for the material terms of the Non-Compete Agreement and supplemental acquisition details and for additional information relating to the third party valuations performed.

Donaghy Asset Purchase Agreement: During 2007, we entered into an asset purchase agreement for \$1.8 million funded primarily by a note payable to Industrial Logistic Services, LLC, the sole member of which is Brian Donaghy, our president and chief operating officer, whereby we pay \$20.0 thousand per month for 60 months for various assets including tractor trailers, trucks and containers. The note payable reflects a seven percent (7.0%) interest payment on the outstanding balance plus principal amortization. During 2011 and 2010, we made payments on this note of \$240.0 thousand. The outstanding balance at December 31, 2011 was \$155.9 thousand.

NOTE 7 - EMPLOYEE RETIREMENT PLAN

We maintain a defined contribution retirement plan under Section 401(k) of the Internal Revenue Code which covers substantially all employees. Eligible employees may contribute a maximum of 15.0% of their annual salary. Under the plan, we match 25.0% of each employee's voluntary contribution up to 6.0% of their gross salary. The expense under the plan for 2011, 2010 and 2009 was \$59.6 thousand, \$56.5 thousand, and \$48.6 thousand, respectively.

NOTE 8 - LEASE COMMITMENTS

Operating Leases:

We lease our Louisville, Kentucky facility from a related party (see Note 6) under an operating lease expiring December 2012. The rent was adjusted in January 2008 per the agreement to monthly payments of \$48.5 thousand through December 2012. In addition, the Company is also responsible for real estate taxes, insurance, utilities and maintenance expense.

We lease equipment from a related party (see Note 6) under operating leases expiring November 2015 and May 2016.

We lease a facility in Dallas, Texas for management services operations. The agreement provided that monthly payments of \$2.5 thousand were paid through September 2006. The lease was renewed effective October 1, 2011 for a one-year period with monthly payments of \$1.0 thousand.

We leased a facility in Lexington, Kentucky for \$4.5 thousand per month; the lease terminated February 10, 2012. We subleased this property for a term commencing March 1, 2007 and ending January 31, 2012 for \$4.5 thousand per month.

Future minimum lease payments for operating leases, in thousands, as of December 31, 2011 are as follows:

| | |
|-------------------------------|-------------------|
| 2012 | \$ 721.2 |
| 2013 | 126.0 |
| 2014 | 126.0 |
| 2015 | 126.0 |
| 2016 | 25.5 |
| Thereafter | _____ |
| | |
| Future minimum lease payments | <u>\$ 1,124.7</u> |

Total rent expense for the years ended December 31, 2011, 2010 and 2009 was \$1.0 million, \$968.9 thousand, and \$1.1 million, 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.

NOTE 9 - CASH DIVIDEND

In 2011 and 2010, the Board of Directors did not declare a cash dividend.

NOTE 10 PER SHARE DATA

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

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|--|--|----------------|----------------|
| | (in thousands, except per share information) | | |
| Basic earnings per share | | | |
| Net (loss) income | \$ (3,881) | \$ 8,053 | \$ 5,285 |
| Weighted average shares outstanding | <u>6,927</u> | <u>6,622</u> | <u>5,783</u> |
| Basic (loss) earnings per share | <u>\$ (0.56)</u> | <u>\$ 1.22</u> | <u>\$ 0.91</u> |
| Diluted earnings per share | | | |
| Net (loss) income | \$ (3,881) | \$ 8,053 | \$ 5,285 |
| Weighted average shares outstanding | 6,927 | 6,622 | 5,783 |
| Add dilutive effect of assumed exercising of stock options | | 44 | 18 |
| Diluted weighted average shares outstanding | <u>6,927</u> | <u>6,666</u> | <u>5,801</u> |
| Diluted (loss) earnings per share | <u>\$ (0.56)</u> | <u>\$ 1.21</u> | <u>\$ 0.91</u> |

NOTE 11 - LEGAL PROCEEDINGS

On January 4, 2007, Lennox Industries, Inc., a commercial heating and air-conditioning manufacturer, filed a suit against us captioned Lennox Industries, Inc. v. Industrial Services of America, Inc., Case No. CV-2007-004, in the Arkansas County, Arkansas Circuit Court in Stuttgart, Arkansas. Lennox in its Second Amended Complaint alleged breach of contract, negligence, and breach of fiduciary duty arising from our 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 termination on November 17, 2005. Both compensatory and punitive damages were sought by Lennox.

A jury trial was held from June 20-24, 2011. The punitive damage claim was withdrawn by Lennox at the conclusion of its case, and Lennox claimed over \$1.0 million in compensatory damages. On June 24, the jury found in ISA's favor on five of the six claims. Lennox was awarded \$175.0 thousand on the remaining claim.

Following the trial, both Lennox and ISA filed motions with the court seeking an award of attorney fees against each other. Lennox also filed a motion requesting an award of pre-judgment interest on the \$175.0 thousand verdict. The Court denied both of Lennox's motions and granted ISA's motion for attorney fees in the amount of \$98.0 thousand against Lennox. No appeal was taken by either party, and a Mutual General Release was signed as part of a final negotiated settlement in which Lennox received \$84.5 thousand. A Satisfaction of Judgment was filed with the court on December 28, 2011, and the case is closed.

We have litigation from time to time, including employment-related claims, none of which we currently

believe to be material.

NOTE 12 - SEGMENT INFORMATION

The Company's operations include two primary segments: Recycling and Waste Services. In prior years, our three primary segments were ISA Recycling, Computerized Waste Systems (CWS), and Waste Equipment Sales & Service (WESSCO). In the first quarter of 2009, we decided to consolidate CWS and WESSCO into one reporting segment because CWS revenues have declined so that this segment is no longer material to our total revenues. We named this combined segment Waste Services because it more accurately reflects that business. Waste Services provides waste disposal services including contract negotiations with service providers, centralized billing, invoice auditing, and centralized dispatching. Waste Services also sells, leases, and services waste handling and recycling equipment. The Recycling segment provides products and services to meet the needs of its customers related to ferrous, non-ferrous and fiber recycling in two locations in the Midwest.

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.

The accounting policies of the two segments are the same as those described in the summary of significant accounting policies (Note 1). 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.

| 2011 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
|--|------------|-------------------|------------|-------------------|
| | | | | (in thousands) |
| Recycling revenues | \$ 269,459 | \$ | \$ | \$ 269,459 |
| Equipment sales, service and leasing revenues | | 2,132 | | 2,132 |
| Management fees | | 5,279 | | 5,279 |
| Cost of goods sold | (259,692) | (5,474) | | (265,166) |
| Inventory adjustment for lower of cost or market | (3,441) | | | (3,441) |
| Selling, general, and administrative expenses | (8,137) | (808) | (3,775) | (12,720) |
| Segment (loss) profit | \$ (1,811) | \$ 1,129 | \$ (3,775) | \$ (4,457) |

| 2011 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
|---|------------------|---------------------------|----------------|---------------------------|
| | | | | (in thousands) |
| Cash | \$ 1,116 | \$ | \$ 1,151 | \$ 2,267 |
| Income tax receivable | | | 3,967 | 3,967 |
| Accounts receivable, net | 16,342 | 940 | (91) | 17,191 |
| Inventories | 18,500 | 44 | | 18,544 |
| Net property and equipment | 18,909 | 1,024 | 6,266 | 26,199 |
| Goodwill | 6,840 | | | 6,840 |
| Net intangibles | 5,025 | | | 5,025 |
| Other assets | 363 | 12 | 562 | 937 |
| | <u>67,095</u> | <u>2,020</u> | <u>11,855</u> | <u>80,970</u> |
| Segment assets | \$ 67,095 | \$ 2,020 | \$ 11,855 | \$ 80,970 |
| | | | | (in thousands) |
| 2010 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
| Recycling revenues | \$ 334,667 | \$ | \$ | \$ 334,667 |
| Equipment sales, service and leasing revenues | | 2,126 | | 2,126 |
| Management fees | | 6,212 | | 6,212 |
| Cost of goods sold | (309,481) | (6,239) | | (315,720) |
| Selling, general, and administrative expenses | (7,469) | (1,016) | (5,252) | (13,737) |
| | <u>17,717</u> | <u>1,083</u> | <u>(5,252)</u> | <u>13,548</u> |
| Segment profit (loss) | \$ 17,717 | \$ 1,083 | \$ (5,252) | \$ 13,548 |
| | | | | (in thousands) |
| 2010 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
| Cash | \$ 1,258 | \$ | \$ 1,210 | \$ 2,468 |
| Accounts receivable, net | 24,933 | 1,140 | 1,376 | 27,449 |
| Inventories | 34,222 | 89 | | 34,311 |
| Net property and equipment | 25,799 | 1,228 | 527 | 27,554 |
| Goodwill | 6,840 | | | 6,840 |
| Net intangibles | 5,775 | | | 5,775 |
| Other assets | 574 | 86 | 1,105 | 1,765 |
| | <u>99,401</u> | <u>2,543</u> | <u>4,218</u> | <u>106,162</u> |
| Segment assets | \$ 99,401 | \$ 2,543 | \$ 4,218 | \$ 106,162 |

| 2009 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
|--|------------------|---------------------------|--------------|---------------------------|
| | | | | (in thousands) |
| Recycling revenues | \$ 171,841 | \$ | \$ | \$ 171,841 |
| Equipment sales, service and leasing revenues | | 2,116 | | 2,116 |
| Management fees | | 7,095 | | 7,095 |
| Cost of goods sold | (154,482) | (6,277) | | (160,759) |
| Inventory adjustment for lower of cost or market | | | | |
| Selling, general, and administrative expenses | (6,280) | (1,333) | (2,875) | (10,488) |
| Segment (loss) profit | \$ 11,079 | \$ 1,601 | \$ (2,875) | \$ 9,805 |

| 2009 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
|----------------------------|------------------|---------------------------|--------------|---------------------------|
| | | | | (in thousands) |
| Cash | \$ 531 | \$ | \$ 182 | \$ 713 |
| Accounts receivable, net | 7,520 | 981 | 11 | 8,512 |
| Inventories | 26,315 | 112 | | 26,427 |
| Net property and equipment | 23,577 | 1,341 | 2,077 | 26,995 |
| Goodwill | 2,567 | | | 2,567 |
| Net intangibles | | | | |
| Other assets | 586 | 22 | 852 | 1,460 |
| Segment assets | \$ 61,096 | \$ 2,456 | \$ 3,122 | \$ 66,674 |

NOTE 13 PURCHASE OF INVENTORY, FIXED ASSETS, AND INTANGIBLE ASSETS OF VENTURE METALS, LLC

On January 13, 2009 we entered into an inventory purchase agreement with Venture Metals, LLC (Venture), a metal recycler focused on stainless steel and high temperature alloys, and its members, Steve Jones, Jeff Valentine and Carlos Corona, under which we agreed to pay to Venture \$8.8 million for inventory comprised of stainless steel and high temperature alloys, which we verified as to weight. Mr. Corona is our employee. We funded the purchase of the inventory through our line of credit with Branch Banking & Trust (BB&T). We subsequently paid an additional \$262.3 thousand for inventory after the final verification of weight. This initial transaction was part of an overall agreement to acquire the operations of Venture.

Under the agreement, we had the right to retain the use of the property located at 3409 Camp Ground Road, Louisville, Kentucky, the site of the Venture business that Venture leases from Luca Investments, LLC (Luca), an affiliate of Venture, owned 50.0% each by Messrs. Jones and Valentine. We had the right to use the facilities located on those premises for a period not to exceed two years from the date of the

agreement for a monthly rental of \$15.0 thousand.

On April 13, 2009, we exercised our option to purchase fixed assets under an installment purchase agreement with Venture, whereby Venture sold all of its fixed assets, located at 3409 Camp Ground Road, Louisville, Kentucky, to us by virtue of an installment purchase agreement effective February 11, 2009. Steve Jones, Jeff Valentine and Carlos Corona were the sole members of Venture. Under the notice of exercise of option to purchase fixed assets we agreed to purchase the fixed assets on April 17, 2009 for the purchase price of \$1.5 million less the aggregate amount of all rent we paid to Venture under the previous agreement. The installment payment we owed to Venture was \$15.0 thousand per month commencing March 1, 2009 with a pro-rata amount paid for the period from February 11, 2009 through February 28, 2009. A further description of the installment purchase agreement and related transactions is contained in Items 1.01 and 2.01 of Form 8-K for the event dated February 11, 2009, as filed on February 18, 2009, with the Securities and Exchange Commission by us.

At the time of the consummation of the option to purchase fixed assets, the installment purchase agreement terminated. In connection with the exercise of the option to purchase, Venture had to satisfy outstanding obligations with respect to the fixed assets owed to a number of creditors. The fixed assets include equipment such as cranes, loaders, scales, forklifts, computers, including computer software, furniture and certain leasehold improvements to the property at 3409 Camp Ground Road, Louisville, Kentucky.

We completed the acquisition of the real property at 3409 Camp Ground Road, Louisville, Kentucky, from Luca on April 2, 2009. Under the agreement, we purchased the property and improvements thereon consisting of 5.67 acres with a 7,875 square foot building located thereon. We paid \$2.1 million for the property, comprised of \$1.3 million in cash and 300,000 shares of ISA common stock priced at the per share NASDAQ last sale price of \$2.67, as quoted on NASDAQ at 10:30 a.m. (EDT) on April 2, 2009. We determined the purchase price for the real estate based on internal analyses as to the value of the property. BB&T provided credit to us under our \$10.0 million line of credit with BB&T funding the cash portion of the purchase price.

Although the above transactions were not completed simultaneously due to timing constraints relating to verification of inventory, fixed asset appraisals, property appraisals, and funding considerations, management's intention from the initial transaction was to purchase the operations of Venture. As the above transactions were completed within the one-year measurement period according to ASC Topic 805, we have treated these combined transactions as an acquisition (the 2009 Acquisition) and have followed FASB's authoritative guidance on business combinations for reporting purposes. Accordingly, the results of operations of the acquired business have been included in the consolidated statement of income since January 2009. With this acquisition, we did not obtain control of Venture, as we did not have any financial interest, variable financial interest, voting interest or shares in Venture, nor did we have or obtain a non-controlling interest in Venture.

The initial purchase price was allocated based on the information available to management and Venture at the time. Management engaged a third party appraiser to determine the fair value of the property and equipment acquired. Subsequent to the completion of this process, we recorded an adjustment to the purchase price allocation amounting to \$2.0 million. Goodwill resulting from this purchase relates to the name recognition of Venture Metals, LLC in the industry as well as synergies expected from the business combination. Any adjustments made to provisional amounts are based on new information obtained about the facts and circumstances that existed as of the acquisition date.

Edgar Filing: INDUSTRIAL SERVICES OF AMERICA INC /FL - Form 10-K

The following table summarizes the purchase price allocation in thousands:

| | Original | Adjustment | Final |
|-----------------------------------|-----------|------------|-----------|
| Inventory | \$ 9,109 | \$ | \$ 9,109 |
| Equipment, furniture and fixtures | 1,499 | (474) | 1,025 |
| Property and improvement | 2,067 | (1,533) | 534 |
| Goodwill | | 2,007 | 2,007 |
| | 12,675 | \$ | 12,675 |
| Less: Amount paid with stock | (800) | | (800) |
| | 11,875 | \$ | 11,875 |
| Cash consideration | \$ 11,875 | \$ | \$ 11,875 |

On March 26, 2010, we entered into an agreement dated July 1, 2010, subject to shareholder approval of certain issuances of shares of our common stock. After shareholder approval of the issuance of 300,000 shares of our common stock, on July 1, 2010, we entered into an asset purchase agreement and a non-compete agreement with Venture. Pursuant to the asset purchase agreement dated July 1, 2010, in consideration for the transfer of the Venture Metals, LLC name and entry into the Non-Compete Agreement, we delivered to Venture 300,000 shares of our common stock based on a price of \$10.41 per share (the Purchase Price) based on the stock price on July 1, 2010. Management determined that the purchase of these intangibles would protect our market position and customer and supplier relationships and also constitutes a separate business acquisition under ASC Topic 805 (the 2010 Acquisition).

The purchase price was negotiated between us and Steve Jones, former co-owner of Venture. After purchasing Mr. Corona's share of Venture on January 1, 2010, Venture was owned by Steve Jones and Jeff Valentine, both of whom were our employees at the time. An outside financial consultant also assessed the transaction to provide an opinion of the fair value of the transaction, which led to a supplemental acquisition dated July 1, 2010, as described below.

The material terms of the Non-Compete Agreement include that (i) Venture, or any entity that Venture may become, operating under any name agrees that for a period of five (5) years from the date of the Agreement (the Non-Competition Period), Venture will not directly or indirectly (a) engage in any business which is the same or substantially the same as any business of the Company (the Restricted Business), or (b) have any interest in any other business venture, whether as a debt or equity holder, member, manager, partner, agent, security holder, consultant or otherwise, that directly or indirectly is engaged in the Restricted Business, within one hundred (100) direct miles of any geographic area in which the Company, its affiliates or any of their respective subsidiaries, engages in the business operations as of the date hereof (the Restricted Area); (ii) during the Non-Competition Period, Venture will not, directly or indirectly, (a) solicit for employment or employ (or attempt to solicit for employment or employ), for Venture or on behalf of any other person (other than the Company or any of its respective subsidiaries), or (b) otherwise encourage any such employee to leave his or her employment with the Company, its affiliates or any of their respective subsidiaries; (iii) during the Non-Competition Period, Venture shall not, directly or indirectly, (a) solicit, call on, or transact or engage in the Restricted Business with (or attempt to do any of the foregoing with respect to) any customer (e.g.: North American Stainless), distributor, vendor, supplier or agent with whom the Company, its affiliates or any of their respective subsidiaries shall have dealt, or that the Company, its affiliates or any of their respective subsidiaries shall have actively sought to deal, for or on behalf of Venture or any other person (other than the Company, its affiliates or any of their respective subsidiaries) in connection with the Restricted Business or (b) encourage any such customer, distributor, vendor, supplier or agent to cease, in whole or in part, its business relationship with the Company, its affiliates or any of their respective subsidiaries; and (iv) if

Venture breaches the terms of this Agreement, the Company will be entitled to the following remedies: (a) damages from Venture; (b) to offset against any and all amounts owing to Venture under the Asset Purchase Agreement any and all amounts which the Company claims under the Agreement; (c) in addition to its right to damages and any other rights it may have to obtain injunctive or other equitable relief to restrain any breach or threatened breach or otherwise to specifically enforce the provisions of this Agreement, it being agreed that money damages alone would be inadequate to compensate the Company and would be an inadequate remedy for such breach; and (d) the rights and remedies of the parties to the Agreement are cumulative and not alternative.

On June 16, 2010, the Company and Venture agreed to a supplemental acquisition, the 2010 Acquisition, dated July 1, 2010. Pursuant to this agreement, on April 12, 2010, the Company paid Venture \$1.3 million for the benefit of Messrs. Jones and Valentine using the line of credit. This amount represents an annual performance bonus in cash equal to seven and one-half percent (7.5%) for both Mr. Jones and Mr. Valentine of the amount determined, for the 2009 fiscal year of the Company, by (i) the Segment profit of the 2009 Acquisition (the Alloys Segment Profit) minus (ii) the product of (a) the selling, general and administrative expenses under the Other category, times (b) the percentage determined by dividing the Alloys Segment Profit by the Segment profit under the Segment Totals category, all as reflected in the Segment Information note of the Notes to Consolidated Financial Statements as contained in the 2009 Annual Report on Form 10-K. The amount was accrued in 2009 by expensing the calculated amount monthly throughout 2009 to bonus expense in the Recycling segment's SG&A expenses. On July 1, 2010, the Company 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 agreed to deliver up to an additional 750,000 shares of ISA Common Stock in accordance with the following:

(a) Venture would 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 such period (but in no event greater than 90,000 shares in any one calendar year) based on satisfaction of certain RONA criteria. Such consideration would be payable in the form of ISA 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;

(b) Venture would 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 certain 5 year (2010-2014) average RONA criteria. Such consideration would 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.

The Company obtained a valuation of the intangibles from an outside source. Of the valuation methodologies considered for the valuation of the intangible assets purchased from Venture, the income approach valuation method was used. In this approach, discounted cash flow analysis measures the value of a company by the present value of its estimated future economic benefits. These benefits can include earnings, cost savings, tax deductions, and proceeds from disposition. Value indications are developed by discounting expected cash flows to their present value at a rate of return that incorporates the risk-free rate for the use of funds, the expected rate of inflation and risks associated with the particular investment. The material assumptions used in the valuation include a discount rate range, a long-term growth rate, a

working capital rate, and a terminal growth rate range. The valuation also includes income projections and capital expenditure forecasts as provided by management. These assumptions and estimates were based on information available at the time the valuation was performed. These assumptions and estimates bear the risk of change as future performance, future economic conditions, and continued major customer relationships cannot be predicted or guaranteed.

Based on preliminary estimates and the share price as of July 1, 2010 of \$10.41 per share, we recorded additional goodwill of \$4.3 million, decreased the value of the intangible asset by \$630.0 thousand, and increased fourth quarter amortization expense related to the intangible assets by \$98.7 thousand. We also recorded a commitment of \$7.3 million to paid in capital representing the fair value of the contingent consideration associated with the purchase of the intangibles as of December 31, 2010. This commitment value was determined based on management's estimate that the probability of achieving the RONA criteria was approximately 94%. The maximum value of the contingent shares is \$7.8 million based on the \$10.41 per share value as of the acquisition date. No changes were made to recorded amounts for goodwill or the other amortized intangible items based on the completion of the valuation in the second quarter of 2011.

On February 24, 2011, we issued 45,000 shares of our common stock each to Steve Jones and Jeff Valentine for the satisfaction of certain RONA criteria for the year ending December 31, 2010. We decreased the contingent consideration value to \$6.4 million.

The Company also obtained a valuation from an outside source to verify our goodwill balance as of December 31, 2011. Of the valuation methodologies considered for the valuation of the goodwill, the income approach valuation method was used. In this approach, discounted cash flow analysis measures the value of a company by the present value of its estimated future economic benefits. These benefits can include earnings, cost savings, tax deductions, and proceeds from disposition. Value indications are developed by discounting expected cash flows to their present value at a rate of return that incorporates the risk-free rate for the use of funds, the expected rate of inflation and risks associated with the particular investment. The material assumptions used in the valuation include a discount rate range, a long-term growth rate, a working capital rate, and a terminal growth rate range. The valuation also includes income projections and capital expenditure forecasts as provided by management. These assumptions and estimates were based on information available at the time the valuation was performed. These assumptions and estimates bear the risk of change as future performance, future economic conditions, and continued major customer relationships cannot be predicted or guaranteed. Based on this valuation, no impairment value was recorded to goodwill.

NOTE 14 - LONG TERM INCENTIVE PLAN

At our June 16, 2009 annual shareholders meeting, shareholders approved ratification of a long term incentive plan and approved the issuance of additional common shares of our stock. At our June 10, 2010 annual shareholders meeting, the shareholders approved the reservation of 1,200,000 additional shares of our common stock under the plan. 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.

For performance-based stock awards granted under this plan, we have assumed that the performance targets for awards granted in a specific year will be achieved. We have assumed that performance targets for future years will not be achieved. Based on these assumptions, we use the closing per share stock price on the date the contract is signed to calculate award values for recording purposes. These calculated amounts reflect the aggregate grant date fair value of the stock awards computed in accordance with ASC Topic 718.

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. We recorded expense related to these stock options of \$95,071 in 2009. See Note 1 Stock Option Plans of these Notes to Consolidated Financial Statements for additional information on this stock option plan.

On January 6, 2010, the Board of Directors granted non-performance based stock awards of 25,500 shares to management at \$6.39 per share. On January 11, 2010, we issued 18,000 shares and on February 11, 2010, we issued the remaining 7,500 shares of this grant. On June 8, 2010, we issued 30,000 thousand shares of our stock granted on April 14, 2009 to management at a grant date fair value of \$2.53 per share. On November 15, 2010, we issued 5,000 shares of our stock to management at \$10.34 per share. In January 2011, we issued 60,000 shares of our stock granted on April 1, 2010 to management at a grant date fair value of \$11.93 per share and 600 shares of our stock to consultants at \$12.28 per share.

NOTE 15 - SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

| 2011 | 1st | 2nd | 3rd | 4th | Year |
|--|------------|-----------|-----------|-----------|------------|
| (in thousands, except per share information) | | | | | |
| Revenue | \$ 106,187 | \$ 64,963 | \$ 55,766 | \$ 49,954 | \$ 276,870 |
| Gross profit (loss) | 7,835 | 4,182 | (1,030) | 717 | \$ 11,704 |
| Inventory write-down | | | (3,441) | | \$ (3,441) |
| Income (loss) before other income (expense) | 4,055 | 1,610 | (7,165) | (2,957) | \$ (4,457) |
| Net income | 2,167 | 313 | (4,536) | (1,825) | \$ (3,881) |
| Basic earnings (loss) per share | 0.31 | 0.05 | (0.67) | (0.26) | (0.56) |
| Diluted earnings (loss) per share | 0.31 | 0.05 | (0.67) | (0.26) | (0.56) |

After a strong first quarter in 2011, sales to our main stainless steel customer began to decline as compared to 2010 due to a decline in demand for stainless steel. Additionally, reduced metal prices caused us to adjust our inventory levels by \$3.4 million to lower of cost or market at the end of the third quarter.

| 2010 | 1st | 2nd | 3rd | 4th | Year |
|--|-----------|-----------|-----------|-----------|------------|
| (in thousands, except per share information) | | | | | |
| Revenue | \$ 74,169 | \$ 92,815 | \$ 76,550 | \$ 99,471 | \$ 343,005 |
| Gross profit | 6,283 | 7,754 | 7,369 | 5,879 | 27,285 |
| Income before other income (expense) | 3,082 | 4,189 | 3,485 | 2,792 | 13,548 |
| Net income | 1,763 | 2,347 | 1,923 | 2,020 | 8,053 |
| Basic earnings per share | 0.27 | 0.36 | 0.28 | 0.30 | 1.22 |
| Diluted earnings per share | 0.27 | 0.36 | 0.28 | 0.29 | 1.21 |

| 2009 | 1st | 2nd | 3rd | 4th | Year |
|--|-----------|-----------|-----------|-----------|------------|
| (in thousands, except per share information) | | | | | |
| Revenue | \$ 24,250 | \$ 39,124 | \$ 79,970 | \$ 37,708 | \$ 181,052 |
| Gross profit | 3,985 | 4,151 | 6,514 | 5,643 | 20,293 |
| Income before other income (expense) | 1,275 | 1,711 | 3,907 | 2,912 | 9,805 |
| Net income | 654 | 922 | 2,161 | 1,548 | 5,285 |
| Basic earnings per share | 0.12 | 0.17 | 0.37 | 0.24 | 0.91 |
| Diluted earnings per share | 0.12 | 0.17 | 0.37 | 0.24 | 0.91 |

Shredder production began in the third quarter of 2009, significantly increasing revenues in the first and second quarters of 2010 as compared to the first and second quarters of 2009. Historically, fourth quarter revenue has decreased; however, in the fourth quarter of 2010, a major customer increased their stainless steel orders by \$57.4 million as compared to the fourth quarter of 2009.

Depreciation expense that was taken in the first three quarters of 2009 in the amount of \$68.4 thousand related to the acquisition of the Venture Metals, LLC was adjusted as a result of finalizing the purchase price allocation resulting in a reduction of depreciation expense in the fourth quarter of 2009.

SUPPLEMENTARY INFORMATION

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS
Years ended December 31, 2011, 2010 and 2009

| Description | Balance at Beginning of Period | Additions Charged to Costs and Expenses | Deductions * | Balance at End of Period |
|--|--------------------------------------|--|--------------|-----------------------------|
| Allowance for doubtful accounts 2011 (deducted from accounts receivable) | \$ 100,000 | \$ | \$ | \$ 100,000 |
| Allowance for doubtful accounts 2010 (deducted from accounts receivable) | \$ 100,000 | \$ | \$ | \$ 100,000 |
| Allowance for doubtful accounts 2009 (deducted from accounts receivable) | \$ 490,000 | \$ | \$ (390,000) | \$ 100,000 |
| Accrual for legal settlements for 2011 | \$ | \$ | \$ | \$ |
| Accrual for legal settlements for 2010 | \$ | \$ | \$ | \$ |
| Accrual for legal settlements for 2009 | \$ 990,000 | \$ | \$ 990,000 | \$ |

* **Uncollected** amounts written off, net of recoveries