

INDUSTRIAL SERVICES OF AMERICA INC /FL
Form 10-Q
August 14, 2012

FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

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

For the quarterly period ended June 30, 2012

OR

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

For the Transition Period From _____ to _____

Commission File Number 0-20979

INDUSTRIAL SERVICES OF AMERICA, INC.

(Exact Name of Registrant as specified in its Charter)

Florida

59-0712746

(State or other jurisdiction of
Incorporation or Organization)

(IRS Employer Identification No.)

7100 Grade Lane, PO Box 32428

Louisville, Kentucky 40232

(Address of principal executive offices)

(502) 368-1661

(Registrant's Telephone Number, Including Area Code)

Check 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 ý No o

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 ý No o

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 o

Accelerated filer o

Non-accelerated filer o

Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of June 30, 2012:

6,944,267

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INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES
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PART I – FINANCIAL INFORMATION

ITEM 1: CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

| | June 30, 2012 (Unaudited) (in thousands) | December 31, 2011 |
|--|---|----------------------|
| Current assets | | |
| Cash and cash equivalents | \$2,575 | \$2,267 |
| Income tax receivable | 886 | 3,967 |
| Accounts receivable – trade (after allowance for doubtful accounts of \$100.0 thousand in 2012 and 2011) | 13,837 | 17,191 |
| Net investment in sales-type leases | 21 | 40 |
| Inventories | 27,555 | 18,544 |
| Deferred income taxes | 368 | 411 |
| Prepaid expenses | 296 | 328 |
| Employee loans | 5 | 6 |
| Total current assets | 45,543 | 42,754 |
| Net property and equipment | 25,417 | 26,199 |
| Other assets | | |
| Notes receivable – related party | 23 | 45 |
| Goodwill | 6,840 | 6,840 |
| Intangible assets, net | 4,650 | 5,025 |
| Deposits | 274 | 107 |
| Total other assets | 11,787 | 12,017 |
| Total assets | \$82,747 | \$80,970 |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
CONTINUED

LIABILITIES AND STOCKHOLDERS' EQUITY

| | June 30, 2012 (Unaudited) (in thousands, except par value and share information) | December 31, 2011 |
|---|--|----------------------|
| Current liabilities | | |
| Current maturities of long-term debt | \$1,715 | \$1,821 |
| Accounts payable | 14,407 | 10,681 |
| Interest rate swap agreements liability | 371 | 484 |
| Other current liabilities | 447 | 331 |
| Total current liabilities | 16,940 | 13,317 |
| Long-term liabilities | | |
| Long-term debt | 27,350 | 26,688 |
| Deferred income taxes | 1,984 | 3,406 |
| Total long-term liabilities | 29,334 | 30,094 |
| Shareholders' equity | | |
| Common stock, \$0.0033 par value: 10,000,000 shares authorized, 7,192,479 shares issued in 2012 and 2011, 6,944,267 and 6,940,517 shares outstanding in 2012 and 2011, respectively | 24 | 24 |
| Additional paid-in capital | 18,210 | 18,131 |
| Retained earnings | 18,826 | 20,057 |
| Accumulated other comprehensive loss | (230) | (290) |
| Treasury stock at cost, 248,212 and 251,962 shares in 2012 and 2011, respectively | (357) | (363) |
| Total shareholders' equity | 36,473 | 37,559 |
| Total liabilities and shareholders' equity | \$82,747 | \$80,970 |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 THREE MONTHS ENDED JUNE 30, 2012 AND 2011
 (UNAUDITED)

| | 2012 | 2011 | |
|--|--|----------|---|
| | (in thousands, except per share information) | | |
| Revenue from services | \$ 1,023 | \$ 1,290 | |
| Revenue from product sales | 48,829 | 63,772 | |
| Total revenue | 49,852 | 65,062 | |
| Cost of goods sold for services | 944 | 1,006 | |
| Cost of goods sold for product sales | 47,340 | 59,612 | |
| Total cost of goods sold | 48,284 | 60,618 | |
| Provision for employee terminations and severances | 17 | — | |
| Other selling, general and administrative expenses | 2,950 | 2,735 | |
| Total selling, general and administrative expenses | 2,967 | 2,735 | |
| (Loss) income before other income (expense) | (1,399 |) 1,709 | |
| Other income (expense) | | | |
| Interest expense | (455 |) (633 |) |
| Interest income | 3 | 5 | |
| Gain on sale of assets | 16 | 92 | |
| Provision for lawsuit settlement | — | (175 |) |
| Other loss, net | — | (502 |) |
| Total other expense | (436 |) (1,213 |) |
| (Loss) income before income taxes | (1,835 |) 496 | |
| Income tax (benefit) provision | (596 |) 183 | |
| Net (loss) income | (1,239 |) 313 | |
| Basic (loss) earnings per share | \$(0.18 |) \$0.05 | |
| Diluted (loss) earnings per share | \$(0.18 |) \$0.05 | |
| Weighted shares outstanding: | | | |
| Basic | 6,944 | 6,790 | |
| Diluted | 6,944 | 6,825 | |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
SIX MONTHS ENDED JUNE 30, 2012 AND 2011
(UNAUDITED)

| | 2012 | 2011 | |
|---|--|-----------|---|
| | (in thousands, except per share information) | | |
| Revenue from services | \$2,308 | \$2,661 | |
| Revenue from product sales | 109,222 | 168,802 | |
| Total revenue | 111,530 | 171,463 | |
| Cost of goods sold for services | 2,137 | 2,283 | |
| Cost of goods sold for product sales | 104,138 | 156,528 | |
| Total cost of goods sold | 106,275 | 158,811 | |
| Provision for employee terminations and severances | 228 | — | |
| Other selling, general, and administrative expenses | 5,949 | 6,673 | |
| Total selling, general and administrative expenses | 6,177 | 6,673 | |
| (Loss) income before other income (expense) | (922 |) 5,979 | |
| Other income (expense) | | | |
| Interest expense | (940 |) (1,518 |) |
| Interest income | 6 | 11 | |
| Gain on sale of assets | 35 | 141 | |
| Provision for lawsuit settlement | — | (175 |) |
| Other loss, net | — | (502 |) |
| Total other expense | (899 |) (2,043 |) |
| (Loss) income before income taxes | (1,821 |) 3,936 | |
| Income tax (benefit) provision | (590 |) 1,456 | |
| Net (loss) income | \$(1,231 |) \$2,480 | |
| Basic (loss) earnings per share | \$(0.18 |) \$0.36 | |
| Diluted (loss) earnings per share | \$(0.18 |) \$0.36 | |
| Weighted shares outstanding: | | | |
| Basic | 6,942 | 6,913 | |
| Diluted | 6,942 | 6,953 | |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
THREE MONTHS ENDED JUNE 30, 2012 AND 2011
(UNAUDITED)

| | 2012 (in thousands) | 2011 |
|--|------------------------|---------|
| Net (loss) income | \$(1,239 |) \$313 |
| Other comprehensive income: | | |
| Unrealized income (loss) on derivative instruments, net of tax | 17 | (7) |
| Comprehensive (loss) income | \$(1,222 |) \$306 |

See accompanying notes to consolidated financial statements.

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INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
SIX MONTHS ENDED JUNE 30, 2012 AND 2011
(UNAUDITED)

| | 2012 (in thousands) | 2011 |
|---|------------------------|-----------|
| Net (loss) income | \$(1,231 |) \$2,480 |
| Other comprehensive income: | | |
| Unrealized income on derivative instruments, net of tax | 60 | 43 |
| Comprehensive (loss) income | \$(1,171 |) \$2,523 |

See accompanying notes to consolidated financial statements.

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INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

SIX MONTHS ENDED JUNE 30, 2012

(UNAUDITED)

| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Treasury Stock | | Total Shareholders' Equity |
|---|--------------|--------|----------------------------------|----------------------|---|----------------|---------|----------------------------------|
| | Shares | Amount | | | | Shares | Cost | |
| (in thousands, except share information) | | | | | | | | |
| Balance as of | | | | | | | | |
| December 31, 2011 | 7,192,479 | \$24 | \$18,131 | \$20,057 | \$(290) | (251,962) | \$(363) | \$37,559 |
| Net unrealized income on derivative instruments, net of tax | — | — | — | — | 60 | — | — | 60 |
| Stock/options bonuses | — | — | 79 | — | — | 3,750 | 6 | 85 |
| Net loss | — | — | — | (1,231) | — | — | — | (1,231) |
| Balance as of | | | | | | | | |
| June 30, 2012 | 7,192,479 | \$24 | \$18,210 | \$18,826 | \$(230) | (248,212) | \$(357) | \$36,473 |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 SIX MONTHS ENDED JUNE 30, 2012 AND 2011
 (UNAUDITED)

| | 2012 | 2011 | |
|--|----------------|-----------|---|
| | (in thousands) | | |
| Cash flows from operating activities | | | |
| Net (loss) income | \$(1,231 |) \$2,480 | |
| Adjustments to reconcile net income to net cash from operating activities: | | | |
| Depreciation and amortization | 2,236 | 2,255 | |
| Stock expense - bonuses and options | 84 | 495 | |
| Deferred income taxes | (1,431 |) — | |
| Gain on sale of property and equipment | (35 |) (141 |) |
| Change in assets and liability | | | |
| Receivables | 3,354 | 7,281 | |
| Net investment in sales-type leases | 19 | 16 | |
| Inventories | (9,011 |) 145 | |
| Income tax receivable | 3,081 | — | |
| Other assets | (134 |) (1,732 |) |
| Accounts payable | 3,536 | (6,385 |) |
| Accrued bonuses | — | (946 |) |
| Income tax payable | — | 456 | |
| Other current liabilities | 116 | 71 | |
| Net cash from operating activities | 584 | 3,995 | |
| Cash flows from investing activities | | | |
| Proceeds from sale of property and equipment | 36 | 154 | |
| Purchases of property and equipment | (547 |) (895 |) |
| Construction in progress | (343 |) — | |
| Deposits on equipment | — | (260 |) |
| Payments from related party | 22 | 21 | |
| Net cash used in investing activities | (832 |) (980 |) |
| Cash flows from financing activities | | | |
| Payments on long-term debt | (946 |) (3,916 |) |
| Proceeds from long-term debt | 1,502 | 517 | |
| Net cash from (used in) financing activities | 556 | (3,399 |) |
| Net increase (decrease) in cash | 308 | (384 |) |
| Cash at beginning of year | 2,267 | 2,468 | |
| Cash at end of period | \$2,575 | \$2,084 | |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for interest | \$871 | \$1,206 | |
| Cash tax refund received | 2,548 | — | |
| Cash paid for taxes | 308 | 1,000 | |
| Supplemental disclosure of noncash investing and financing activities | | | |
| Equipment accrual | 190 | — | |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("GAAP") for complete consolidated financial statements. The Accounting Standards Codification ("ASC") as produced by the Financial Accounting Standards Board ("FASB") is the sole source of authoritative GAAP for non-governmental entities. The information furnished includes all adjustments, which are, in the opinion of management, necessary to present fairly our financial position as of June 30, 2012 and the results of our operations and changes in our cash flow for the periods ended June 30, 2012 and 2011. Results of operations for the period ended June 30, 2012 are not necessarily indicative of the results that may be expected for the entire year. Additional information, including the audited December 31, 2011 consolidated financial statements and the Summary of Significant Accounting Policies, is included in our Annual Report on Form 10-K for the year ended December 31, 2011 on file with the Securities and Exchange Commission.

Estimates

In preparing the condensed consolidated financial statements in accordance with U. S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, management must make estimates and assumptions. These estimates and assumptions affect the amounts reported for assets, liabilities, revenues and expenses, as well as affecting the disclosures provided. Examples of estimates include the allowance for doubtful accounts, estimates associated with annual goodwill impairment tests, estimates of deferred income tax assets and liabilities, estimates of inventory balances, and estimates of stock option values. 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.

Restatements and Reclassifications

We have reclassified certain income statement items within the accompanying Condensed Consolidated Financial Statements and Notes to Condensed Consolidated Financial Statements for the prior year in order to be comparable with the current presentation. These reclassifications had no effect on previously reported income.

Fair Value

We carry certain of our financial assets and liabilities at fair value on a recurring basis. These financial assets and liabilities are composed of cash and cash equivalents and derivative instruments. Long-term debt is carried at cost, and the fair value is disclosed herein. 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 accounting standard, we categorize our financial assets and liabilities into the following fair value hierarchy:

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

Level 2 – Financial assets and liabilities with values based on quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability. Examples of level 2 financial instruments include commercial paper purchased from the State Street-administered asset-backed commercial paper conduits, various types of interest-rate derivative

instruments, and various types of fixed-income investment securities. Pricing models are utilized to estimate fair value for certain financial assets and liabilities categorized in level 2.

Level 3 – Financial assets and liabilities with values based on prices or valuation techniques that require inputs that are both unobservable in the market and significant to the overall fair value measurement. These inputs reflect management’s judgment about the assumptions that a market participant would use in pricing the asset or liability, and are based on the best available

information, some of which is internally developed. Examples of level 3 financial instruments include certain corporate debt with little or no market activity and a resulting lack of price transparency.

When determining the fair value measurements for financial assets and liabilities carried at fair value on a recurring basis, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability. When possible, we look to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, we look to market observable data for similar assets and liabilities. Nevertheless, certain assets and liabilities are not actively traded in observable markets, and we use alternative valuation techniques to derive fair value measurements. We use the fair value methodology outlined in the related accounting standard to value the assets and liabilities for cash, debt and derivatives. All of our cash is defined as Level 1 and all our debt and derivative contracts are defined as Level 2. In accordance with this guidance, the following table represents our fair value hierarchy for Level 1 and Level 2 financial instruments at June 30, 2012 (in thousands):

| Assets | Level 1 | Level 2 | Total |
|--|---------|------------|------------|
| Cash and cash equivalents | \$2,575 | \$— | \$2,575 |
| Liabilities | | | |
| Long-term debt | \$— | \$(29,065) | \$(29,065) |
| Derivative contract - interest rate swap | — | (371) | (371) |

We have had no transfers in or out of Levels 1 or 2 fair value measurements, and no activity in Level 3 fair value measurements for the three month and six month periods ended June 30, 2012. For Level 3 assets, goodwill is subject to impairment analysis each year end under Phase I of the ASC guidance. We hired an independent third party to evaluate Level 3 assets for impairment as of December 31, 2011. No impairment adjustment was necessary.

Stock Option Plan

We provide compensation benefits by granting stock options to employees and directors. 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 5 years. We recognize share-based compensation expense for the fair value of the awards, as estimated using the Modified Black-Scholes-Merton Model, on the date granted on a straight-line basis over their vesting term. Compensation expense is recognized only for share-based payments expected to vest. We estimate forfeitures at the date of grant based on our historical experience and future expectations.

There are two significant inputs into the Black-Scholes option pricing model: expected volatility and expected term. We estimate expected volatility based on traded option volatility of the our stock over a term equal to the expected term of the option granted. The expected term of stock option awards granted is derived from historical exercise experience under the our long-term incentive plan and represents the period of time that stock option awards granted are expected to be outstanding. The assumptions used in calculating the fair value of stock-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if factors change and we use different assumptions, stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate, and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from its estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period.

As of May 15, 2012, we awarded options to purchase 30.0 thousand shares of our stock each to our three new directors for a total of 90.0 thousand shares at a per share exercise price of \$4.94, the fair value as of the grant date. As of June 30, 2012, the unrecognized stock-based compensation cost related to non-vested option awards was \$129.5 thousand and such amount will be recognized in operations over the vesting period of 1 year. Stock compensation charged to operations was \$24.0 thousand as of June 30, 2012. We did not charge any stock compensation to operations as of June 30, 2011.

See also Note 10 - "Long Term Incentive Plan" in these Notes to Consolidated Financial Statements for additional information regarding the Long Term Incentive Plan.

Factoring fees

We have included factoring fees with interest expense. These fees were previously recorded as discounts taken and totaled \$101.4 thousand and \$312.5 thousand for the year-to-date periods ending June 30, 2012 and 2011, respectively.

Subsequent Events

We have evaluated the period from June 30, 2012 through the date the financial statements herein were issued for subsequent events requiring recognition or disclosure in the financial statements and the following event was identified:

On August 13, 2012, Industrial Services of America, Inc. and ISA Indiana, Inc. (the "Companies") entered into a Fourth Amendment to Credit Agreement (the "Fourth 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"), the Second Amendment to Credit Agreement dated as of November 16, 2011 (the "November Amendment"), and the Third Amendment to Credit Agreement dated as of March 2, 2012 (the "Third Amendment") as follows. The Fourth Amendment decreased our maximum revolving commitment by \$10.0 million to \$30.0 million and extended the maturity date of both the revolving credit facility and the term loan from July 31, 2013 to October 31, 2013. The Fourth Amendment also provided a waiver of the Senior Leverage Ratio and Fixed Charge Coverage Ratio covenant defaults for the quarter ending June 30, 2012. The Fourth Amendment changed our covenant to maintain a ratio of debt to adjusted EBITDA (the "Senior Leverage Ratio") from 3.50 to 1 in the third quarter of 2012 to 4.75 to 1 in the third quarter of 2012. The ratio in the fourth quarter of 2012 and thereafter remains at 3.25 to 1. The Fourth Amendment also changed our covenant to maintain a ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled payment of principal (the "Fixed Charge Coverage Ratio") from not less than 1.2 to 1 to not less than 1.0 to 1 for the third quarter of 2012, and to not less than 1.5 to 1 for the fourth quarter of 2012. For every test period thereafter, it will return to not less than 1.2 to 1. The Fourth Amendment also increased the interest rate for both the revolving credit facility and the term loan by fifty basis points (0.50%) to 3.50% and 3.75%, respectively. The rate will decrease by twenty-five basis points (0.25%) if the Companies achieve a Senior Leverage Ratio of 3.50 to 1 or below beginning with the quarter ending September 30, 2012. In addition, the Companies also agreed to perform other customary commitments and pay a fee of \$25.0 thousand to the Bank. All other terms of the Credit Agreement and previous Amendments remain in effect. See also Note 4 - "Long Term Debt and Notes Payable" in these Notes to Consolidated Financial Statements for additional information regarding the Fourth Amendment.

NOTE 2 – CHANGE IN ESTIMATE

As of June 2012, the Company adopted a new method for estimating residual value amounts for automotive vehicle parts and appliances held in inventory. The new method was adopted due to the ongoing evaluation of our experience with the materials produced from our shredder operations. This change in estimate provides a more accurate value of these residual values in inventory and was applied prospectively in accordance with FASB ASC 250, "Accounting Changes and Error Corrections." The impact of this change resulted in an increase in the cost of goods sold of \$352.1 thousand for the six month period ended June 30, 2012.

NOTE 3 – INTANGIBLE ASSETS

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

Intangible assets are considered to have indefinite lives when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate cash flows for the Company. The factors considered in making this determination include the existence of contractual rights for unlimited terms and the life cycles of the products and processes that depend on the asset.

We have the following intangible assets as of June 30, 2012:

| Gross Carrying Value | Accumulated Amortization | Net Carrying Value |
|----------------------------|-----------------------------|--------------------------|
|----------------------------|-----------------------------|--------------------------|

| Amortized intangible assets | (in thousands) | | |
|-----------------------------------|----------------|----------|-----------|
| Venture Metals, LLC trade name | \$730 | \$(292 |) \$438 |
| Non-compete agreements | 620 | (248 |) 372 |
| Venture Metals, LLC customer list | 4,800 | (960 |) 3,840 |
| Total intangible assets | \$6,150 | \$(1,500 |) \$4,650 |

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 \$375.0 thousand for the six month periods ending June 30, 2012 and 2011.

As of June 30, 2012, we expect amortization expense for these assets for the next five fiscal years and thereafter to be as follows:

| Year (in thousands) | 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) |) — |

NOTE 4 – LONG TERM DEBT AND NOTES PAYABLE TO BANK

On August 13, 2012, Industrial Services of America, Inc. and ISA Indiana, Inc. (the “Companies”) entered into a Fourth Amendment to Credit Agreement (the “Fourth 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”), the Second Amendment to Credit Agreement dated as of November 16, 2011 (the “November Amendment”), and the Third Amendment to Credit Agreement dated as of March 2, 2012 (the “Third Amendment”) as follows. The Fourth Amendment decreased our maximum revolving commitment by \$10.0 million to \$30.0 million and extended the maturity date of both the revolving credit facility and the term loan from July 31, 2013 to October 31, 2013. The Fourth Amendment also provided a waiver of the Senior Leverage Ratio and Fixed Charge Coverage Ratio covenant defaults for the quarter ending June 30, 2012. The Fourth Amendment changed our covenant to maintain a ratio of debt to adjusted EBITDA (the “Senior Leverage Ratio”) from 3.50 to 1 in the third quarter of 2012 to 4.75 to 1 in the third quarter of 2012. The ratio in the fourth quarter of 2012 and thereafter remains at 3.25 to 1. The Fourth Amendment also changed our covenant to maintain a ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled payment of principal (the “Fixed Charge Coverage Ratio”) from not less than 1.2 to 1 to not less than 1.0 to 1 for the third quarter of 2012, and to not less than 1.5 to 1 for the fourth quarter of 2012. For every test period thereafter, it will return to not less than 1.2 to 1. The Fourth Amendment also increased the interest rate for both the revolving credit facility and the term loan by fifty basis points (0.50%) to 3.50% and 3.75%, respectively. The rate will decrease by twenty-five basis points (0.25%) if the Companies achieve a Senior Leverage Ratio of 3.50 to 1 or below beginning with the quarter ending September 30, 2012. In addition, the Companies also agreed to perform other customary commitments and pay a fee of \$25.0 thousand to the Bank. All other terms of the Credit Agreement and previous Amendments remain in effect.

On March 2, 2012, the Companies entered into the Third Amendment with the Bank which amended the Credit Agreement, including the April Amendment and the November Amendment, as follows. The Third Amendment redefines the calculation period for the purpose of measuring compliance with the Senior Leverage Ratio and the Fixed Charge Coverage Ratio of not less than 1.20 to 1 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 3.50 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.

On April 14, 2011, we entered into the April Amendment with the Bank which amended 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 amended 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 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, as of June 30, 2012, the interest rate was the one month LIBOR plus two hundred fifty basis points (2.50%) per annum, adjusted monthly on the first day of each month. As of June 30, 2012, the interest rate was 3.00%. We also pay a fee of 0.75% on the unused portion. As of June 30, 2012 the revolving credit facility expired on July 31, 2013. Pursuant to the Fourth Amendment, the interest rate was raised by fifty basis points (0.50%) and the revolving credit facility expiration date was extended to October 31, 2013. As of June 30, 2012, the outstanding balance on the revolving line of credit was \$21.6 million.

The \$8.8 million term loan provides for an interest rate that is twenty-five basis points (0.25%) higher than the interest rate for the revolving credit facility, which is 3.25% as of June 30, 2012. Principal and interest is payable monthly in 36 consecutive installments of approximately \$125.0 thousand. The first such payment commenced September 1, 2010. As of June 30, 2012, the final payment of the then-unpaid balance became due and payable in full on July 31, 2013. Pursuant to the Fourth Amendment, the interest rate was raised by fifty basis points (0.50%) and the final payment becomes due and payable in full on October 31, 2013. In addition, we will make an annual payment equal to 25% of (i) our adjusted 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. Based on 2011 operating results, no annual payment was required in 2012 for the 2011 fiscal year. The next annual payment will be due on April 30, 2013 (or earlier, upon completion of the Company's financial statements for the fiscal year ending December 31, 2012). 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 June 30, 2012, the outstanding balance on the term loan was \$6.4 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 3.50 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. Pursuant to the Third Amendment, the Senior Leverage Ratio increased to 4.25 to 1 for the period ending March 31, 2012. The Senior Leverage Ratio decreased to 3.50 to 1 for the period ending June 30, 2012. Pursuant to the Fourth Amendment, the

Senior Leverage Ratio increased to 4.75 to 1 for the period ending September 30, 2012 and will decrease to 3.25 to 1 for the period ending December 31, 2012 and thereafter. The Senior Leverage Ratio will, in each quarter, be calculated using a measurement period beginning January 1, 2012 and ending at the end of the quarterly measurement period. The other covenants will remain the same going forward. As of June 30, 2012, we were not in compliance with the covenants in (i) and (ii) above. As of June 30, 2012, our ratio of debt to adjusted EBITDA was 6.59; our ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled principal payments was 0.43. As of June 30, 2012, capital expenditures totaled \$889.9 thousand, which includes \$342.9 thousand in construction in progress. We received a waiver from the bank for the quarter ending June 30, 2012 for failing to meet the ratio requirements for covenants (i) and (ii) above. As of June 30, 2012, we have \$18.4 million available to us under our existing credit facilities.

On April 12, 2011, we entered into a Loan and Security Agreement with the Bank pursuant to which the Bank agreed to provide the Company with a Promissory Note (the "April Note") in the amount of \$226.9 thousand for the purpose of purchasing operating equipment. The interest rate is five and sixty-eight hundredths 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 April Note. As of June 30, 2012, the outstanding balance of this loan was \$160.3 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 June 30, 2012, the outstanding balance of this loan was \$93.1 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 two tenths percent (5.20%) per annum. Principal and interest is payable monthly in 48 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 June 30, 2012, the outstanding balance on the October Note was \$802.4 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 June 30, 2012 of \$39.6 thousand.

We entered into three interest rate swap agreements swapping variable rates for fixed rates. The first swap agreement covers approximately \$4.5 million in debt, commenced April 7, 2009, and matures on April 7, 2014. The second swap agreement covers approximately \$2.0 million in debt, commenced October 15, 2008, and matures on May 7, 2013. The third swap agreement covers approximately \$429.9 thousand in debt, commenced October 22, 2008, and matures on October 22, 2013. The three swap agreements fix our interest rate at approximately 5.8%. At June 30, 2012, we recorded the estimated fair value of the liability related to the three swaps at approximately \$371.3 thousand. We entered into the swap agreements for the purpose of hedging the interest rate market risk for the respective notional amounts. We maintain a cash account on deposit with BB&T which serves as collateral for the swap agreements. As of June 30, 2012, the balance in this account was \$438.0 thousand.

Our long term debt as of June 30, 2012 and December 31, 2011 consisted of the following:

| | 2012 (Unaudited) (in thousands) | 2011 |
|---|---------------------------------------|----------|
| Revolving credit facility of \$40.0 million with Fifth Third Bank. See above description for additional details. | \$21,585 | \$20,083 |
| 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. | 6,385 | 7,015 |
| 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. | 802 | 962 |
| Loan and Security Agreement payable to Fifth Third Bank in the amount of \$226.9 thousand secured by the equipment purchased with the proceeds. See above description for additional details. | 160 | 187 |
| Note payable to Fifth Third Bank in the amount of \$115.0 thousand secured by the equipment purchased with the proceeds. See above description for additional details. | 93 | 106 |
| Note payable to ILS for various assets including tractor trailers, trucks and containers. The repayment terms are \$20.0 thousand per month for 60 months at a seven percent (7.0%) interest rate. The maturity date under this agreement is August 2012. | 40 | 156 |
| | 29,065 | 28,509 |
| Less current maturities | 1,715 | 1,821 |
| | \$27,350 | \$26,688 |

The annual maturities of long term debt (in thousands) as of June 30, 2012 are as follows:

| | |
|------------|----------|
| 2012 | \$1,715 |
| 2013 | 27,148 |
| 2014 | 197 |
| 2015 | 5 |
| Thereafter | — |
| Total | \$29,065 |

NOTE 5 – SEGMENT INFORMATION

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

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

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

| FOR THE SIX MONTHS ENDED JUNE 30, 2012 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
|---|----------------|-------------------|------------|-------------------|
| | (in thousands) | | | |
| Recycling revenues | \$108,118 | \$— | \$— | \$108,118 |
| Equipment sales, service and leasing revenues | — | 1,104 | — | 1,104 |
| Management fees | — | 2,308 | — | 2,308 |
| Cost of goods sold | (103,792) | (2,483) | — | (106,275) |
| Selling, general, and administrative expenses | (3,643) | (376) | (2,158) | \$(6,177) |
| Segment profit (loss) | \$683 | \$553 | \$(2,158) | \$(922) |
| Segment assets | \$72,116 | \$1,832 | \$8,799 | \$82,747 |
| | | | | |
| FOR THE SIX MONTHS ENDED June 30, 2011 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
| | (in thousands) | | | |
| Recycling revenues | \$167,637 | \$— | \$— | \$167,637 |
| Equipment sales, service and leasing revenues | — | 1,165 | — | 1,165 |
| Management fees | — | 2,661 | — | 2,661 |
| Cost of goods sold | (156,103) | (2,708) | — | (158,811) |
| Selling, general, and administrative expenses | (4,524) | (385) | (1,764) | (6,673) |
| Segment profit (loss) | \$7,010 | \$733 | \$(1,764) | \$5,979 |
| Segment assets | \$88,689 | \$2,179 | \$8,066 | \$98,934 |
| | | | | |
| FOR THE THREE MONTHS ENDED JUNE 30, 2012 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
| | (in thousands) | | | |
| Recycling revenues | \$48,236 | \$— | \$— | \$48,236 |
| Equipment sales, service and leasing revenues | — | 593 | — | 593 |
| Management fees | — | 1,023 | — | 1,023 |
| Cost of goods sold | (47,158) | (1,126) | — | (48,284) |
| Selling, general, and administrative expenses | (1,831) | (193) | (943) | (2,967) |
| Segment profit (loss) | \$(753) | \$297 | \$(943) | \$(1,399) |
| Segment assets | \$72,116 | \$1,832 | \$8,799 | \$82,747 |
| | | | | |
| FOR THE THREE MONTHS ENDED JUNE 30, 2011 | RECYCLING | WASTE SERVICES | OTHER | SEGMENT TOTALS |
| | (in thousands) | | | |
| Recycling revenues | \$63,185 | \$— | \$— | \$63,185 |
| Equipment sales, service and leasing revenues | — | 587 | — | 587 |
| Management fees | — | 1,290 | — | 1,290 |
| Cost of goods sold | (59,400) | (1,218) | — | (60,618) |
| Selling, general, and administrative expenses | (2,203) | (191) | (341) | (2,735) |
| Segment profit (loss) | \$1,582 | \$468 | \$(341) | \$1,709 |
| Segment assets | \$88,689 | \$2,179 | \$8,066 | \$98,934 |

NOTE 6 – INVENTORIES

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

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

As of June 2012, the Company adopted a new method for estimating residual value amounts for automotive vehicle parts and appliances held in inventory. The new method was adopted due to the ongoing evaluation of our experience with the materials produced from our shredder operations. This change in estimate provides a more accurate value of these residual values in inventory and was applied prospectively in accordance with FASB ASC 250, "Accounting Changes and Error Corrections." The impact of this change resulted in an increase in the cost of goods sold of \$352.1 thousand for the six month period ended June 30, 2012.

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. Other inventory includes fuel, cardboard and baling wire.

Inventories as of June 30, 2012 and December 31, 2011 consist of the following:

| | June 30, 2012 | | | | December 31, 2011 | | | |
|--|------------------------------------|-------------------|---------------------|----------------------|-------------------|-------------------|---------------------|----------|
| | Raw Materials (in thousands) | Finished Goods | Processing Costs | Total (unaudited) | Raw Materials | Finished Goods | Processing Costs | Total |
| Stainless steel, ferrous and non-ferrous materials | \$23,260 | \$1,199 | \$1,275 | \$25,734 | \$14,633 | \$1,409 | \$777 | \$16,819 |
| Waste equipment | — | 85 | — | 85 | — | 39 | — | 39 |
| machinery | — | 69 | — | 69 | — | 63 | — | 63 |
| Other | — | 69 | — | 69 | — | 63 | — | 63 |
| Total inventories for sale | 23,260 | 1,353 | 1,275 | 25,888 | 14,633 | 1,511 | 777 | 16,921 |
| Replacement parts | 1,667 | — | — | 1,667 | 1,623 | — | — | 1,623 |
| Total inventories | \$24,927 | \$1,353 | \$1,275 | \$27,555 | \$16,256 | \$1,511 | \$777 | \$18,544 |

NOTE 7 - LEASE COMMITMENTS

Operating Leases:

We lease our Louisville, Kentucky facility from a related party under an operating lease expiring December 2012. The rent was adjusted in December 2007 per the Company's agreement to make monthly payments of \$48.5 thousand through December 2012. In addition, we are also responsible for real estate taxes, insurance, utilities and maintenance expense.

We lease office space in Dallas, Texas for which monthly payments of \$1.0 thousand are due through September 2012.

We lease equipment from a related party under operating leases expiring in November 2015 and May 2016 for a monthly payment totaling \$10.5 thousand.

We lease a lot in Louisville, Kentucky for a term commencing in March 2012 and ending in February 2016. The monthly payment

amount from March 2012 through February 2014 is \$3.5 thousand. The monthly payment amount then increases to \$3.8 thousand for the remaining term.

Future minimum lease payments for operating leases in thousands as of June 30, 2012 are as follows:

| | |
|-------------------------------|-------|
| 2012 | \$441 |
| 2013 | 168 |
| 2014 | 171 |
| 2015 | 134 |
| 2016 | 8 |
| Thereafter | — |
| Future minimum lease payments | \$922 |

Total rent expense for the six months ended June 30, 2012 and 2011 was \$472.7 thousand and \$557.2 thousand, respectively.

NOTE 8 - PROVISION FOR EMPLOYEE TERMINATIONS AND SEVERANCES

In the six month period ended June 30, 2012, the Company accrued \$228.4 thousand for expenses related to employee terminations and severances.

NOTE 9 – PER SHARE DATA

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

Six months ended June 30, 2012 compared to six months ended June 30, 2011:

| | 2012 | 2011 |
|--|--|------------|
| | (in thousands, except per share information) | |
| Basic (loss) earnings per share | | |
| Net (loss) income | \$ (1,231 |) \$ 2,480 |
| Weighted average shares outstanding | 6,942 | 6,913 |
| Basic (loss) earnings per share | \$ (0.18 |) \$ 0.36 |
| Diluted (loss) earnings per share | | |
| Net (loss) income | \$ (1,231 |) \$ 2,480 |
| Weighted average shares outstanding | 6,942 | 6,913 |
| Add dilutive effect of assumed exercising of stock options | — | 40 |
| Diluted weighted average shares outstanding | 6,942 | 6,953 |
| Diluted (loss) earnings per share | \$ (0.18 |) \$ 0.36 |

Three months ended June 30, 2012 compared to three months ended June 30, 2011:

| | 2012 | 2011 |
|--|--|----------|
| | (in thousands, except per share information) | |
| Basic (loss) earnings per share | | |
| Net (loss) income | \$(1,239 |) \$313 |
| Weighted average shares outstanding | 6,944 | 6,790 |
| Basic (loss) earnings per share | \$(0.18 |) \$0.05 |
| Diluted (loss) earnings per share | | |
| Net (loss) income | \$(1,239 |) \$313 |
| Weighted average shares outstanding | 6,944 | 6,790 |
| Add dilutive effect of assumed exercising of stock options | — | 35 |
| Diluted weighted average shares outstanding | 6,944 | 6,825 |
| Diluted (loss) earnings per share | \$(0.18 |) \$0.05 |

NOTE 10 – LONG TERM INCENTIVE PLAN

The Company's long term incentive plan makes available up to 2.4 million 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, or total shareholder return.

The plan is administered by a committee selected by the Board, initially our Compensation Committee, and consisting 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.

The Company uses the Modified Black-Scholes-Merton option-pricing model to value the Company's stock options for each stock option award. Using this option-pricing model, the fair value of each stock option award is estimated on the date of grant. The fair value of the Company's stock option awards, which are generally subject to pro-rata vesting annually over one year, is expensed on a straight-line basis over the vesting period of the stock options. The expected volatility assumption is based on traded options volatility of the Company's stock over a term equal to the expected term of the option granted. The expected term of stock option awards granted is derived from historical exercise experience under the Company's stock option plans and represents the period of time that stock option awards granted are expected to be outstanding. The expected term assumption incorporates the contractual term of an option grant, which is five years, as well as the vesting period of an award, which is generally pro-rata vesting annually over one year. The risk-free interest rate is based on the implied yield on a U.S. Treasury constant maturity with a remaining term equal to the expected term of the option granted.

The Company recognizes stock-based compensation costs, net of estimated forfeitures, for only those shares expected to vest on a straight-line basis over the requisite service period of the award. The Company estimates the forfeiture rates based on its historical experience. Treasury shares are issued for exercised options. The Company does not expect to repurchase any additional shares within the following annual period to accommodate the exercise of outstanding stock options.

The weighted average assumptions relating to the valuation of the Company's stock options awarded in May, 2012 is shown below. No stock options were granted during 2011.

| | |
|---|-----------|
| | 2012 |
| Weighted average grant-date fair value of grants per option | \$1.71 |
| Volatility | 52.8% |
| Risk-free interest rate | 2.5% |
| Expected life | 2.5 years |
| Expected dividend yield | 0.0% |

The following table presents a summary of the Company's stock option activity:

| Options | Number of shares (in thousands) | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term | Weighted Average Grant Date Fair Value |
|---|------------------------------------|---|---|--|
| Outstanding at January 1, 2011 (vested) | 90 | \$4.23 | 3.5 years | \$1.05 |
| Granted | — | — | — | — |
| Outstanding at December 31, 2011 | 90 | \$4.23 | 2.5 years | \$1.05 |
| Granted (nonvested) | 90 | 4.94 | 5 years | 1.71 |
| Outstanding at June 30, 2012 | 180 | \$4.59 | 3.4 years | \$1.38 |
| Vested and expected to vest in the future at June 30, 2012 | 180 | | | |
| Exercisable at June 30, 2012 | 90 | \$4.23 | 2 years | \$1.05 |
| Available for grant at June 30, 2012 | 2,095 | | | |

As of July 1, 2009, we awarded options to purchase 30.0 thousand shares of our stock each to our three independent directors for a total of 90.0 thousand shares at a per share exercise price of \$4.23. We recorded expense related to these stock options of \$95.1 thousand in 2009. These options are outstanding as of June 30, 2012. As of May 15, 2012, we awarded options to purchase 30.0 thousand shares of our stock each to our three new directors for a total of 90.0 thousand shares at a per share exercise price of \$4.94, the fair value as of the grant date. We recorded expense related to these stock options of \$24.0 thousand for the quarter ended June 30, 2012. See Note 1 - "Summary of Significant Accounting Policies" of these Consolidated Financial Statements for additional information on the stock option plan.

In January 2011, we issued 60.0 thousand shares of our stock to management. These shares were granted pursuant to performance based stock plans authorized on April 1, 2010, at a grant date fair value of \$11.93 per share. We also issued non-performance based stock awards of 0.6 thousand shares to consultants at \$12.28 per share in January 2011. On April 9, 2012, we issued 3.8 thousand shares of our stock to a previous executive. These shares were granted pursuant to a performance based stock plan authorized on August 13, 2010, at a grant date fair value of \$15.98 per share with performance requirements met on August 15, 2011.

NOTE 11 – LEGAL PROCEEDINGS

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

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

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

The following discussion and analysis contains certain financial predictions, forecasts and projections which constitute "forward-looking statements" within the meaning of the federal securities laws. Actual results could differ materially from those financial predictions, forecasts and projections and there can be no assurance that we will achieve such financial predictions, forecasts and projections. Factors that could affect financial predictions, forecasts and projections include the fluctuations in the commodity price index and any conditions internal to our major customers, including loss of their accounts and other factors as listed in our Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission.

General

We are primarily focusing our attention now and in the future towards our recycling business. We sell processed ferrous and non-ferrous scrap material to end-users such as steel mini-mills, integrated steel makers, foundries and refineries. We deliver all scrap ourselves or through third parties via truck, rail car, and/or barge. Some customers choose to send their own delivery trucks, which are weighed and loaded at one of our sites based on the sales order. We purchase ferrous and non-ferrous scrap material primarily from industrial and commercial generators of steel, iron, aluminum, copper, stainless steel and other metals as well as from other scrap dealers who deliver these materials directly to our facilities. We process these materials by shredding, sorting, shearing, cutting and/or baling. We will also continue to focus on initiating growth in our waste services business segment, which includes management services and waste and recycling equipment sales, service and leasing.

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 we utilize an active database of over 7,000 vendors to provide timely, thorough and cost-effective service to our customers. 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.

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

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

Liquidity and Capital Resources

As of June 30, 2012 we held cash and cash equivalents of \$2.6 million. Included in the \$2.6 million is a cash account on deposit with BB&T which serves as collateral for our swap agreements. As of June 30, 2012, the balance in this account was \$438.0 thousand. Other than this balance, our cash accounts are available to us without restriction.

On August 13, 2012, Industrial Services of America, Inc. and ISA Indiana, Inc. (the "Companies") entered into a Fourth Amendment to Credit Agreement (the "Fourth 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"), the Second Amendment to Credit Agreement dated as of November 16, 2011 (the "November Amendment"), and the Third Amendment to Credit Agreement dated as of March 2, 2012 (the "Third Amendment") as follows. The Fourth Amendment decreased our maximum revolving commitment by \$10.0 million to \$30.0 million and extended the maturity date of both the revolving credit facility and the term loan from July 31, 2013 to October 31, 2013. The Fourth Amendment also provided a waiver of the Senior Leverage Ratio and Fixed Charge Coverage Ratio covenant defaults for the quarter ending June 30, 2012. The Fourth Amendment changed our covenant to maintain a ratio of debt to adjusted EBITDA (the "Senior Leverage Ratio") from 3.50 to 1 in the third quarter of 2012 to 4.75 to 1 in the third quarter of 2012. The ratio in the fourth quarter of 2012 and thereafter remains at 3.25 to

1. The Fourth Amendment also changed our covenant to maintain a ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled payment of principal (the "Fixed Charge Coverage Ratio") from not less than 1.2 to 1 to not less than 1.0 to 1 for the third quarter of 2012, and to not less than 1.5 to 1 for the fourth quarter of 2012. For every test period thereafter, it will return to not less than 1.2 to 1. The Fourth Amendment also increased the interest rate for both the revolving credit facility and the term loan by fifty basis points (0.50%) to 3.50% and 3.75%, respectively. The rate will decrease by twenty-five basis points (0.25%) if the Companies achieve a Senior Leverage Ratio of 3.50 to 1 or below beginning with the quarter ending September 30, 2012. In addition, the Companies also agreed to perform other customary commitments and pay a fee of \$25.0 thousand to the Bank. All other terms of the Credit Agreement and previous Amendments remain in effect. See also Note

4 - "Long Term Debt and Notes Payable" in these Notes to Consolidated Financial Statements for additional information regarding the Fourth Amendment.

On March 2, 2012, the Companies entered into the Third Amendment with the Bank which amended the Credit Agreement, including the April Amendment and the November Amendment, as follows. The Third Amendment redefines the calculation period for the purpose of measuring compliance with the Senior Leverage Ratio and the Fixed Charge Coverage Ratio of not less than 1.20 to 1 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 3.50 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.

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 3.50 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. Pursuant to the Third Amendment, the Senior Leverage Ratio increased to 4.25 to 1 for the period ending March 31, 2012. The Senior Leverage Ratio decreased to 3.50 to 1 for the period ending June 30, 2012. Pursuant to the Fourth Amendment, the Senior Leverage Ratio increased to 4.75 to 1 for the period ending September 30, 2012 and will decrease to 3.25 to 1 for the period ending December 31, 2012 and thereafter. The Senior Leverage Ratio will, in each quarter, be calculated using a measurement period beginning January 1, 2012 and ending at the end of the quarterly measurement period. The other covenants will remain the same going forward. As of June 30, 2012, we were not in compliance with the covenants in (i) and (ii) above. As of June 30, 2012, our ratio of debt to adjusted EBITDA was 6.59; our ratio of adjusted EBITDA to aggregate cash payments of interest expense and scheduled principal payments was 0.43. As of June 30, 2012, capital expenditures totaled \$889.9 thousand, which includes \$342.9 thousand in construction in progress. We received a waiver from the bank for the quarter ending June 30, 2012 for failing to meet the ratio requirements for covenants (i) and (ii) above. As of June 30, 2012, we have \$18.4 million available to us under our existing credit facilities.

We have long term debt comprised of the following:

| | June 30, 2012 (Unaudited) (in thousands) | December 31, 2011 |
|--------------------------|---|----------------------|
| Revolving line of credit | 21,585 | 20,083 |
| Notes payable | 7,480 | 8,426 |
| | \$29,065 | \$28,509 |

Pursuant to the Fourth Amendment, our revolving credit facility was reduced to \$30.0 million. This revolving credit facility expires and the \$8.8 million term loan becomes due and payable in full on October 31, 2013. We intend to restructure these credit arrangements to extend the maturity date beyond a one-year period prior to December 31, 2012.

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 and restructuring of the arrangements beyond a one-year period, as mentioned above. As of June 30, 2012, we do not have any material commitments for capital expenditures.

Results of Operations

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

| | Six months ended | | | |
|--|------------------|---------|--|---|
| | June 30, 2012 | 2011 | | |
| Statements of Operations Data: | | | | |
| Total Revenue | 100.0 | % 100.0 | | % |
| Cost of goods sold | 95.3 | % 92.6 | | % |
| Selling, general and administrative expenses | 5.5 | % 3.9 | | % |
| Income before other expenses | (0.8 |)% 3.5 | | % |

Six months ended June 30, 2012 compared to six months ended June 30, 2011

Total revenue decreased \$60.0 million or 35.0% to \$111.5 million in the six month period ended June 30, 2012 as compared to \$171.5 million in the same period in 2011. Recycling revenue decreased \$59.5 million or 35.5% to \$108.1 million in the six month period ended June 30, 2012 compared to \$167.6 million in the same period in 2011. This is primarily due to a decrease of 32.3 million pounds, or 42.9%, in the volume of stainless steel materials shipments due to a continued decrease in worldwide stainless steel demand beginning in the second quarter of 2011. 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 both the second and third quarters of 2011. As demand began to recover, this customer increased sales orders in the fourth quarter of 2011 and again in the first quarter of 2012. Demand in the second quarter of 2012 slowed again, causing another decrease in sales orders from this customer during this time period. The volume of ferrous materials shipments also decreased by 22.3 thousand gross tons, or 20.2%, as compared to the same period in 2011. While some scrap buyers provide consistently competitive pricing from year to year, others may provide competitive pricing one year but not the next. This market-driven competition causes our preferred buyer base to fluctuate from year to year. In the six month period ended June 30, 2012, sales to comparable Recycling scrap buyers decreased by approximately \$59.0 million, or 35.3%, as compared to the same period in 2011. New and competitively priced, intermittent scrap buyers sales totaled approximately \$8.4 million in the six month period ended June 30, 2012. Sales during this period in 2011 to intermittent scrap buyers with non-competitive prices in 2012 totaled \$9.9 million. In addition to the reduction in volume, total revenue was also affected by the decrease in overall average price for all commodities shipped by \$184.04 per gross ton, or 18.7%. Specifically, average nickel prices on the London Metal Exchange decreased \$3.30 per pound, or 28.5%, for the six month period ended June 30, 2012 as compared to average nickel prices for the same period in 2011. Nickel is a key commodity used in stainless steel blends. These decreases were partially offset by an increase of 2.4 million pounds, or 16.6%, in the volume of nonferrous materials shipments.

Waste Services revenue decreased \$0.4 million or 10.5% to \$3.4 million in the six month period ended June 30, 2012 compared to \$3.8 million in the same period in 2011 primarily due to lower average cardboard prices in these time frames, which lowered cardboard recycling revenue by \$186.5 thousand. The average cardboard price was \$20.00 per ton lower in the six month period ended June 30, 2012 compared to the same period in 2011. In general, the timing of services provided or equipment installed will cause fluctuations in Waste Services revenue between periods. Also, for industrial customers, recycling volumes and prices for similar commodities decreased by 267.6 thousand pounds or 3.0% and \$0.03 per pound or 17.0%, respectively, in this period in 2012 as compared to the same period in 2011. The recycling revenue generated for these customers is originally paid to Waste Services from Recycling. This revenue is then passed on to the customer as an off-setting expense for Waste Services cost of sales, which causes a decrease in Waste Services cost of sales when comparing the same periods of 2012 and 2011, as described below.

Total cost of goods sold decreased \$52.5 million or 33.1% to \$106.3 million in the period ended June 30, 2012 as compared to \$158.8 million for the same period in 2011. Recycling cost of goods sold decreased \$52.3 million or 33.5% to \$103.8 million in the six month period ended June 30, 2012 as compared to \$156.1 million for the same period in 2011. This decrease is primarily due to the decrease in the volume of stainless steel and ferrous materials shipments along with a decrease in the volume of stainless steel materials purchases of 16.3 million pounds, or 23.7%,

and a decrease in the volume of ferrous materials purchases of 32.2 thousand gross tons, or 23.6%. Overall average price for all commodities purchased decreased \$73.26, or 8.8%. Direct labor costs also decreased by \$644.1 thousand due to two manager level employees leaving the Company, fewer average employees on weekly payroll in 2012 as compared to 2011, and decreased production due to the continued decline in market demand for stainless steel and other metals. These factors caused decreases in overtime expense of \$220.0 thousand, contract labor expense of \$167.3 thousand, maintenance labor expense of \$103.9 thousand, and other labor expense of \$152.9 thousand.

Other decreases in cost of goods sold include the following:

- ▲ decrease in repair and maintenance expenses of \$333.8 thousand;
- ▲ decrease in hauling, fuel and lubricant expenses of \$142.1 thousand;
- ▲ decrease in depreciation expense of \$55.9 thousand;
- ▲ decrease in utilities of \$49.7 thousand; and
- ▲ decrease in lease and rent expense of \$47.9 thousand.

These decreases are partially offset by the increase in the volume of nonferrous materials shipments as noted above and an increase in the volume of nonferrous materials purchases of 2.1 million pounds, or 11.0%. Processing costs increased \$178.0 thousand or 13.4% in the period ended June 30, 2012 as compared to the same period in 2011. Waste Services cost of goods sold decreased \$0.2 million or 7.4% to \$2.5 million in the six month period ended June 30, 2012 compared to \$2.7 million in the same period in 2011. We often use third party haulers to meet customers' Waste Services needs. We then pay these third party providers and in turn invoice our customers for these amounts. The decrease above was primarily due to the timing of these third party haulers' services provided and their invoices received, the decrease in industrial customers' recycling volumes and prices mentioned above, along with the decrease in cardboard prices mentioned above.

Selling, general and administrative expenses decreased \$0.5 million or 7.5% to \$6.2 million in the period ended June 30, 2012 compared to \$6.7 million in the same period in 2011. As a percentage of revenue, selling, general and administrative expenses were 5.5% in 2012 compared to 3.9% in 2011. The primary driver of the decrease in selling, general and administrative expenses was a decrease in management fees, directors' fees, and consulting fees of \$263.3 thousand.

Additional decreases include the following:

- ▲ decrease in legal expenses of \$146.7 thousand;
- ▲ decrease in operating supplies expenses of \$118.7 thousand;
- ▲ decrease in repair and maintenance expenses of \$106.8 thousand;
- ▲ decrease in fuel, lubricant, and hauling expenses of \$103.3 thousand; and
- ▲ decrease in property taxes, license taxes and fees of \$93.0 thousand.

These decreases were partially offset by an increase in labor expenses of \$325.9 thousand, of which \$228.4 thousand relates to a provision for termination and severance expenses in the six month period ended June 30, 2012.

Other expense decreased \$1.1 million to \$0.9 million in the period ending June 30, 2012 as compared to other expense of \$2.0 million in the same period in 2011. This was primarily due to a decrease in interest expense of \$579.0 thousand due to lower debt levels in 2012. Other expense also decreased by \$501.6 thousand due to purchase contract termination fees paid in 2011 that were not taken in 2012. Additionally, an accrual for a legal settlement of \$175.0 thousand paid in 2011 was not necessary in 2012. These decreases were partially offset by a decrease in the gain on sale of assets of \$106.4 thousand.

The income tax provision decreased \$2.1 million to a benefit of \$0.6 million in the period ended June 30, 2012 compared to an expense of \$1.5 million in the same period in 2011 due to the decreased net income reported in 2012. The effective tax rates in 2012 and 2011 were 32.4% and 37.0%, respectively, based on federal and state statutory rates. Beginning in the first quarter of 2011, we were able to take advantage of the Domestic Production Activities Deduction available to US-based manufacturing companies. In the second quarter of 2012, we had an additional tax expense of approximately \$77.0 primarily due to a prior year correction of the state and city returns.

Three months ended June 30, 2012 compared to three months ended June 30, 2011

Total revenue decreased \$15.2 million or 23.3% to \$49.9 million in the second quarter of 2012 compared to \$65.1 million in the same period in 2011. Recycling revenue decreased \$15.0 million or 23.7% to \$48.2 million in 2012

compared to \$63.2 million in 2011. This is primarily due to a decrease of 1.9 million pounds, or 9.4%, in the volume of stainless steel materials shipments due to a decrease in worldwide stainless steel demand beginning in the second quarter of 2011. 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 both the second and third quarters of 2011. As demand began to recover, this customer increased sales orders in the fourth quarter of 2011 and again in the first quarter of 2012. Demand in the second quarter of 2012 slowed again, causing another decrease in sales orders from this customer during this time period. The volume of ferrous and nonferrous materials shipments also decreased by 18.4 thousand gross tons, or 29.0%, and 2.9 million pound, or 26.0%, respectively, as compared to the same period in 2011. While some scrap buyers provide consistently competitive pricing from year to year, others may provide competitive pricing one year but not the next. This market-driven competition causes our preferred buyer base to fluctuate from year to year. In 2012, sales to comparable Recycling scrap buyers decreased by approximately \$15.3 million, or 24.1%, compared to the same period in 2011. New and competitively priced, intermittent scrap buyers sales in the second quarter of 2012 totaled approximately \$5.1 million. Sales during this period in 2011 to intermittent scrap buyers with non-competitive prices in 2012 totaled \$7.7 million. In addition to the reduction in volume, total revenue was also affected by the decrease in overall average price for all commodities shipped by \$32.75 per gross ton, or 4.2%. Specifically, average nickel prices on the London Metal Exchange decreased \$3.18 per pound, or 29.0%, in the second quarter of 2012 as compared to average nickel prices for the same period of 2011. Nickel is a key commodity used in stainless steel blends.

Waste Services revenue decreased \$0.3 million or 15.8% to \$1.6 million in the second quarter of 2012 compared to \$1.9 million in the same period in 2011 primarily due to lower cardboard prices in the three month period ended June 30, 2012 as compared to the same period in 2011, which lowered cardboard recycling revenue by \$93.8 thousand. In general, the timing of services provided or equipment installed will cause fluctuations in Waste Services revenue between periods. Also, for industrial customers, recycling volumes and prices for similar commodities decreased by 418.8 thousand pounds or 9.3% and \$0.04 per pound or 25.9%, respectively, in this period in 2012 as compared to the same period in 2011. The recycling revenue generated for these customers is originally paid to Waste Services from Recycling. This revenue is then passed on to the customer as an off-setting expense for Waste Services cost of sales, which causes a decrease in Waste Services cost of sales when comparing the same periods of 2012 and 2011, as described below.

Total cost of goods sold decreased \$12.3 million or 20.3% to \$48.3 million in the second quarter of 2012 compared to \$60.6 million for the same period in 2011. Recycling cost of goods sold decreased \$12.2 million or 20.5% to \$47.2 million in 2012 compared to \$59.4 million for the same period in 2011. This decrease is primarily due to the decrease in the volume of stainless steel, ferrous and nonferrous materials shipments along with a decrease in the volume of ferrous and nonferrous materials purchases of 17.6 thousand gross tons, or 26.1%, and 1.7 million pounds, or 15.5%, respectively. Direct labor costs also decreased by \$298.7 thousand, along with a decrease in repair and maintenance expenses of \$178.0 thousand, and a decrease in hauling, fuel and lubricant expense of \$105.2 thousand. These decreases are partially offset by the increase in stainless steel materials purchases of 3.3 million pounds, or 19.1%. In 2012, the Company broadened its customer base, began brokered sales, and began building blends for specialty mills. Inventory levels in the beginning of the second quarter in 2012 were lower than the 2011 levels during the same period; however, the future expected sales orders were higher at the end of the second quarter of 2012 than at the end of the second quarter of 2011. Thus, the Company increased purchases in the second quarter of 2012 to meet the inventory needs of current and future sales orders. Overall average price for all commodities purchased also increased \$33.14, or 4.9%. Processing costs increased \$88.5 thousand or 15.4% in the three month period ended June 30, 2012 as compared to June 30, 2011.

Waste Services cost of goods sold decreased \$0.1 million or 8.3% to \$1.1 million in the second quarter of 2012 compared to \$1.2 million in same period in 2011. We often use third party haulers to meet customers' Waste Services needs. We then pay these third party providers and in turn invoice our customers for these amounts. The decrease above was primarily due to the timing of these third party haulers' services provided and their invoices received, the decrease in industrial customers' recycling volumes and prices mentioned above, and the decrease in cardboard prices mentioned above.

Selling, general and administrative expenses increased \$0.3 million or 11.1% to \$3.0 million in the second quarter of 2012 compared to \$2.7 million in the same period in 2011. As a percentage of revenue, selling, general and administrative expenses were 6.0% in 2012 compared to 4.2% in 2011. The primary driver of the increase in selling, general and administrative expenses was an increase in bonus expense of \$502.7 thousand due to two manager level

employees leaving the Company in April, 2011. The accrual for their bonuses was reversed in the second quarter of 2011. Employment-related taxes increased by \$58.1 thousand primarily due to a state unemployment tax refund received in June 2011 that was not applicable in 2012. The payroll processor had withheld this tax at a rate higher than required in the first quarter of 2011. Tax rates in 2012 were correct. Labor expenses also increased by \$48.6 thousand primarily due to the replacement of several employees who left the Company in the second quarter of 2011 or were not on the payroll at all in the second quarter of 2011 but their replacements are on the payroll in the second quarter of 2012. Stock options expense increased by \$24.0 thousand due to the stock options granted to the three new directors in May 2012.

These increases were partially offset by the following:

- ▲ decrease in management fees, directors' fees, and consulting fees of \$110.5 thousand;
- ▲ decrease in legal fees of \$77.1 thousand;

- ▲ decrease in operating supplies expense of \$59.3 thousand;
- ▲ decrease in repairs and maintenance expense of \$44.3 thousand;
- ▲ decrease in hauling, fuel and lubricants expenses of \$33.8 thousand;
- ▲ decrease in property taxes, licenses and fees of \$25.3 thousand;
- ▲ decrease in utilities and telephone expenses of \$21.2 thousand; and
- ▲ decrease in lease and rent expense of \$21.0 thousand.

Other expense decreased \$0.8 million to \$0.4 million in the second quarter of 2012 compared to other expense of \$1.2 million in the same period in 2011. This was primarily due to the purchase contract termination fees of \$501.6 thousand paid in the second quarter of 2011 that did not take place in 2012. Interest expense also decreased by \$177.5 thousand due to lower debt levels in 2012 and the accrual for a legal settlement of \$175.0 thousand paid in 2011 was not applicable in 2012. These decreases in other expense were partially offset by a decrease in the gain on sale of assets of \$75.7 thousand.

The income tax provision decreased \$0.8 million to a benefit of \$0.6 million in the second quarter of 2012 compared to \$0.2 million in expense in the same period in 2011 due to the decreased net income reported in 2012. The effective tax rates in 2012 and 2011 were 32.5% and 37.0%, respectively, based on federal and state statutory rates. Beginning in the first quarter of 2011, we were able to take advantage of the Domestic Production Activities Deduction available to US-based manufacturing companies. In the second quarter of 2012, we had an additional tax expense of approximately \$77.0 thousand primarily due to a prior year correction for the state and city returns.

Financial condition at June 30, 2012 compared to December 31, 2011

Cash and cash equivalents increased \$0.3 million to \$2.6 million as of June 30, 2012 compared to \$2.3 million as of December 31, 2011.

Net cash from operating activities was \$0.6 million for the six month period ended June 30, 2012. The net cash from operating activities is primarily due to an increase in accounts payable of \$3.5 million (this amount is net of the increase in the equipment accrual of \$0.2 million), a decrease in accounts receivable of \$3.4 million, and a decrease in income tax receivable of \$3.1 million, partially offset by an increase in inventories of \$9.0 million and a decrease of \$1.4 million in deferred income taxes. In 2012, the Company broadened its customer base, added brokered sales, and began building blends for specialty mills. Primarily due to these factors, purchase volumes of stainless steel and other nickel-based scrap increased 4.9 million pounds or 31.2% in the quarter ended June 30, 2012 as compared to the quarter ended December 31, 2011. This increase in purchasing caused the increase in inventory and accounts payable balances. The decrease in accounts receivable relates to the decrease in shipping volumes of stainless steel materials of 1.4 million pounds or 7.2% in the quarter ended June 30, 2012 as compared to the quarter ended December 31, 2011. We received tax refunds of \$2.5 million during the six month period ended June 30, 2012. No refunds were received during this period in 2011. Accounts receivable and payable balances are also affected by the timing of shipments, receipts, and payments throughout the quarter.

We used net cash in investing activities of \$0.8 million for the six month period ended June 30, 2012. In the first six months of 2012, we used \$42.6 thousand for road and building improvements. We purchased recycling and rental fleet equipment and office equipment of \$482.1 thousand. The rental fleet equipment consists of solid waste handling and recycling equipment such as compactors and balers. It is our intention to continue to pursue this market. We spent \$22.5 thousand on vehicle improvements. We spent \$342.7 thousand for construction in progress. We received \$36.2 thousand from sales of our rental fleet compactors and \$22.4 thousand in payments from related parties.

Net cash from financing activities was \$0.6 million for the six month period ended June 30, 2012. In the period ended June 30, 2012, we made payments on debt obligations of \$0.9 million and received \$1.5 million in proceeds from debt.

Accounts receivable trade decreased \$3.4 million or 19.8% to \$13.8 million as of June 30, 2012 compared to \$17.2 million as of December 31, 2011. The volume of stainless steel materials shipments decreased 1.4 million pounds, or 7.2%. The volume of non ferrous materials shipments decreased by 23.4 thousand pounds, or 0.3%, in the second quarter of 2012 as compared to the fourth quarter of 2011. These decreases were partially offset by an increase in the volume of ferrous materials shipments of 1.9 thousand gross tons, or 4.5%. In general, the accounts receivable balance fluctuates due to the timing of shipments and receipt of customer payments.

Inventories consist principally of stainless steel, ferrous and nonferrous scrap materials and waste equipment machinery held for resale. We value inventory at the lower of cost or market. Inventory increased \$9.0 million or 48.6% to \$27.5 million as of June 30, 2012 compared to \$18.5 million as of December 31, 2011. In 2012, the Company broadened its customer base, began brokered

sales, and began building blends for specialty mills. Inventory levels in the beginning of the second quarter in 2012 were lower than the 2011 levels; however, the future expected sales orders were higher at the end of the second quarter of 2012 than at the end of the second quarter of 2011. Thus, the Company increased purchases in the second quarter of 2012 to meet the inventory needs of current and future sales orders. The volume of stainless steel materials purchases increased by 4.9 million pounds, or 31.2% in the second quarter of 2012 as compared to the fourth quarter of 2011. The overall average price of all commodities purchased increased by \$8.39 per gross ton, or 1.2%, during this time period.

Inventory aging for the period ended June 30, 2012 (Days Outstanding):

| Description | (in thousands) | | | | Total |
|--|----------------|---------|---------|---------|----------|
| | 1 - 30 | 31 - 60 | 61 - 90 | Over 90 | |
| Stainless steel, ferrous and non-ferrous materials | \$18,469 | \$1,489 | \$1,205 | \$4,573 | \$25,736 |
| Replacement parts | 1,665 | — | — | — | 1,665 |
| Waste equipment machinery | — | 30 | — | 55 | 85 |
| Other | 69 | — | — | — | 69 |
| Total | \$20,203 | \$1,519 | \$1,205 | \$4,628 | \$27,555 |

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 in the “Over 90 days” category as of June 30, 2012 and December 31, 2011 includes several materials that were bought in bulk that had intrinsic values for stainless steel blends. We purchased the bulk materials in anticipation of continued high demand for stainless steel shipments as well as other specialty metal shipments. These materials are low value items that can only be used in limited quantities. If demand increases, these items will be slowly worked out of the system. Inventory controls have been put into place to assure proper turnover ratios. Inventory in this category as of June 30, 2012 also includes vehicle inventory held for use in the third quarter.

Accounts payable trade increased \$3.7 million or 34.6% to \$14.4 million as of June 30, 2012 compared to \$10.7 million as of December 31, 2011, primarily due to increased purchasing activity in the second quarter of 2012 as compared to the fourth quarter of 2011, noted above, and the timing of payments made to our vendors. The equipment accrual also increased \$0.2 million during this period.

Working capital decreased \$0.8 million to \$28.6 million as of June 30, 2012 compared to \$29.4 million as of December 31, 2011. The decrease was driven by the the \$3.7 million increase in accounts payable, the \$3.4 million decrease in accounts receivable, and the \$3.1 million decrease in income tax receivable. These decreases were partially offset by \$9.0 million increase in inventories, the \$0.3 million increase in cash, and the \$0.1 million decrease in current maturities of long term debt.

Contractual Obligations

The following table provides information with respect to our known contractual obligations for the quarter ended June 30, 2012.

| 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 | \$29,065 | \$1,715 | \$27,345 | \$5 | \$— |
| Operating lease obligations ⁽¹⁾ | 922 | 441 | 339 | 142 | — |
| Total | \$29,987 | \$2,156 | \$27,684 | \$147 | \$— |

We lease the Louisville, Kentucky facility from K&R, LLC, the sole member of which is Harry Kletter, our chief executive officer, under an operating lease expiring December 2012. We have monthly rental payments of \$48.5 thousand through December 2012. In the event of a change of control, the monthly payments become \$62.5 thousand.

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 lot in Louisville, Kentucky for a term commencing in March 2012 and ending in February 2016. The monthly payment amount from March 2012 through February 2014 is \$3.5 thousand. The monthly payment amount then increases to \$3.8 thousand for the remaining term.

We subleased the Lexington property to an unaffiliated third party for a term commencing on 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 February 10, 2012.

We also lease office space in Dallas, Texas for which monthly payments of \$1.0 thousand are due through September 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.

Long-term debt, including the current portions thereof, increased \$0.6 million to \$29.1 million as of June 30, 2012 compared to \$28.5 million as of December 31, 2011.

Impact of Recently Issued Accounting Standards

In September 2011, the Financial Accounting Standards Board ("FASB") issued ASU 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 was permitted. The adoption of ASU 2011-08 did not 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,

in December 2011, the FASB issued ASU 2011-12, which 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. As ASU 2011-05 relates only to the presentation of Comprehensive Income, the adoption of such did not have a material impact on our Condensed Consolidated Financial Statements.

In May 2011, the FASB issued ASU 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 was not permitted. The adoption of ASU 2011-04 did not have a material impact on our Condensed Consolidated Financial Statements.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Fluctuating commodity prices affect market risk in our recycling segment. We mitigate this risk by selling our product on a monthly contract basis. Each month we negotiate selling prices for all commodities. Based on these monthly agreements, we determine purchase prices based on a margin needed to cover processing and administrative expenses. We are exposed to commodity price risk, mainly associated with variations in the market price for ferrous and nonferrous metal, and other commodities. The timing and magnitude of industry cycles are difficult to predict and are impacted by general economic conditions. We respond to changes in recycled metal selling prices by adjusting purchase prices on a timely basis and by turning rather than holding inventory in expectation of higher prices. However, financial results may be negatively impacted where selling prices fall more quickly than purchase price adjustments can be made or when levels of inventory have an anticipated net realizable value that is below average cost.

We are exposed to interest rate risk on our floating rate borrowings.

Based on our average anticipated borrowings under our credit agreements in fiscal 2012, a hypothetical increase or decrease in the LIBOR rate by 1% would increase or decrease interest expense on our variable borrowings by 1% of the outstanding balance, with a corresponding change in cash flows.

We entered into three interest rate swap agreements with BB&T swapping variable rates for fixed rates in a previous year. The first swap agreement covers \$4.5 million in debt, commenced April 7, 2009, and matures on April 7, 2014. The second swap agreement covers approximately \$2.0 million in debt, commenced October 15, 2008, and matures on May 7, 2013. The third swap agreement covers approximately \$429.9 thousand in debt, commenced October 22, 2008, and matures on October 22, 2013. The three swap agreements fix our interest rate at approximately 5.8%. At June 30, 2012, we recorded the estimated fair value of the liability related to the three swaps as approximately \$371.3 thousand. We entered into the swap agreements for the purpose of hedging the interest rate market risk for the respective notional amounts. We maintain a cash account on deposit with BB&T which serves as collateral for the swap agreements. As of June 30, 2012, the balance in this account was \$438.0 thousand.

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

ITEM 4: CONTROLS AND PROCEDURES

(a) Disclosure controls and procedures.

ISA's management, including ISA's principal executive officer and principal financial officer, have evaluated the effectiveness of our "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934. Based upon their evaluation, our principal executive officer and principal financial officer concluded that, as of June 30, 2012, 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

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communicated to ISA's management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding the required disclosure.

(b) Changes to internal control over financial reporting

There were no changes in ISA's internal control over financial reporting during the three months ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect ISA's internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

We have had no material changes from the risk factors reported in our Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission on March 7, 2012.

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

On April 9, 2012, we issued 3.8 thousand shares of our common stock to Daniel Gascoyne, our former Executive Vice-President of Recycling. These shares were granted pursuant to a performance based stock plan authorized on August 13, 2010, at a grant date fair value of \$15.98 per share with performance requirements met on August 15, 2011. The issuance of shares to Mr. Gascoyne was a private offering exempt from registration under Section 4(2) of the Securities Act of 1933, as amended.

On May 15, 2012, we awarded options to purchase 30.0 thousand shares of our stock each to our three new directors (Dr. David Russell, Ms. Francesca Scarito, and Mr. Alan Gildenberg) for a total of 90.0 thousand shares at a per share exercise price of \$4.94. We recorded expense related to these stock options of \$24.0 thousand for the quarter ending June 30, 2012. The vesting period of these options is 1 year. The maximum term of the options is 5 years. See Note 1 - "Summary of Significant Accounting Policies" of these Consolidated Financial Statements for additional information on the stock option plan. The issuance of options to our new board members was a private offering exempt from registration under Section 4(2) of the Securities Act of 1933, as amended.

Beginning November 17, 2005, our Board of Directors authorized a program to repurchase up to 300,000 shares of our common stock at current market prices. This program has no termination date. No shares were repurchased in 2012, 2011, 2010 or 2009. In 2008, we repurchased 83,411 shares. Prior to 2008, we repurchased 83,264 shares.

Issuer Purchases of Equity Securities

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

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

See exhibit index.

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SIGNATURES

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

Date: August 14, 2012

INDUSTRIAL SERVICES OF AMERICA, INC.
/s/ Harry Kletter
Vice-Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: August 14, 2012

/s/ Alan Schroering
VP of Finance and Interim Chief Financial Officer

INDEX TO EXHIBITS

| Exhibit Number | Description of Exhibits |
|----------------|--|
| 10.1 | Fourth Amendment to Credit Agreement, dated August 13, 2012, by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank. |
| 10.2 | Exhibit D (Compliance Certificate) of Fourth Amendment to Credit Agreement, dated August 13, 2012 by and among Industrial Services of America, Inc., ISA Indiana, Inc. and Fifth Third Bank. |
| 10.3 | Amended and Restated Revolving Loan Note, dated August 13, 2012, by Industrial Services of America, Inc. and ISA Indiana, Inc. in favor of Fifth Third Bank. |
| 31.1 | Rule 13a-14(a) Certification of Harry Kletter for the Form 10-Q for the quarter ended June 30, 2012. |
| 31.2 | Rule 13a-14(a) Certification of Alan Schroering for the Form 10-Q for the quarter ended June 30, 2012. |
| 32.1 | Section 1350 Certification of Harry Kletter and Alan Schroering for the Form 10-Q for the quarter ended June 30, 2012. |
| 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* |

*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.