

INDUSTRIAL SERVICES OF AMERICA INC /FL
Form 10-Q
November 05, 2008

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

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

For the quarterly period ended September 30, 2008

OR

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

For the Transition Period From _____ to _____

Commission File Number 0-20979

INDUSTRIAL SERVICES OF AMERICA, INC.

(Exact Name of Registrant as specified in its Charter)

Florida

(State or other jurisdiction of
Incorporation or Organization)

59-0712746

(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

X No ___

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

(Check one): Large accelerated filer _____ Accelerated filer _____
Non-accelerated filer _____ Smaller reporting company X

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of September 30, 2008: 3,575,292.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

INDEX

	Page No.
Part I	
Financial Information	
Condensed Consolidated Balance Sheets September 30, 2008 (Unaudited) and December 31, 2007	3
Condensed Consolidated Statements of Operations - Three Months Ended September 30, 2008 and 2007 (Unaudited)	5
Condensed Consolidated Statements of Operations - Nine Months Ended September 30, 2008 and 2007 (Unaudited)	6
Condensed Consolidated Statements of Shareholders' Equity September 30, 2008 (Unaudited) and December 31, 2007	7
Condensed Consolidated Statements of Cash Flows - Nine Months Ended September 30, 2008 and 2007 (Unaudited)	8
Notes to Condensed Consolidated Financial Statements (Unaudited)	9
Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Part II	
Other Information	30

Part I -- FINANCIAL INFORMATION

ITEM 1: Condensed CONSOLIDATED FINANCIAL STATEMENTS.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	<u>September 30,</u> <u>2008</u> <u>(Unaudited)</u>	<u>December 31,</u> <u>2007</u>
Current assets		
Cash and cash equivalents	\$ 3,060,139	\$ 1,501,685
Income tax receivable	99,358	100,737
Accounts receivable - trade (after allowance for doubtful accounts of \$100,000 in 2008 and 2007)	8,834,094	6,764,851
Net investment in sales-type leases	52,568	60,364
Inventories	6,471,067	4,627,281
Deferred income taxes	141,636	141,636
Other	48,876	318,496
 Total current assets	 18,707,738	 13,515,050
Shredder system construction in progress	5,119,436	-
Net property and equipment	10,362,882	9,537,345
Total property and equipment	15,482,318	9,537,345
Other Assets		
Goodwill	560,005	560,005
Net investment in sales-type leases	85,679	125,851
Notes receivable - related party	176,898	204,053
Deposit for shredder system	-	2,173,076
Other assets	155,238	169,142
	977,820	3,232,127
	\$ 35,167,876	\$ 26,284,522

See accompanying notes to consolidated financial statements.

3.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
CONTINUED

LIABILITIES AND STOCKHOLDERS' EQUITY

	<u>September 30,</u> <u>2008</u> <u>(Unaudited)</u>	<u>December 31,</u> <u>2007</u>
Current liabilities		
Current maturities of long term debt	\$ 440,876	\$ 338,913
Current maturities of capital lease obligation	81,451	133,675
Accounts payable	4,867,323	4,665,631
Income tax payable	1,513,605	-
Other current liabilities	1,014,140	436,791
Total current liabilities	7,917,395	5,575,010
Long-term liabilities		
Long-term debt	10,817,020	8,393,784
Capital lease obligation	40,481	101,569
Deferred income taxes	1,074,721	194,721
	11,932,222	8,690,074
Commitments		
Stockholders' equity		
Common stock, \$.005 par value, 10,000,000 shares authorized, 4,295,000 shares issued in 2008 and 2007, 3,575,292 shares outstanding in 2008 and 3,620,899 in 2007	21,475	21,475
Additional paid-in capital	3,742,373	3,599,624
Retained earnings	13,102,802	9,434,733
Treasury stock, 719,708 shares at average cost in 2008 and 674,101 in 2007	(1,548,391)	(1,036,394)
	15,318,259	12,019,438
	\$ 35,167,876	\$ 26,284,522

See accompanying notes to consolidated financial statements.

4.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007
(UNAUDITED)

	<u>2008</u>	<u>2007</u>
Revenue from services	\$ 4,875,379	\$ 4,311,553

Revenue from product sales	23,962,449	13,617,257
Total Revenue	28,837,828	17,928,810
Cost of goods sold for services	4,578,407	3,841,742
Cost of goods sold for product sales	19,749,262	11,980,863
Reduction of cost of goods sold	-	(337,516)
Total Cost of goods sold	24,327,669	15,485,089
Selling, general and administrative expense	2,569,743	1,791,116
Income before other income (expense)	1,940,416	652,605
Other income (expense)		
Interest expense	(76,628)	(91,096)
Interest income	19,060	30,238
Gain/(loss) on sale of assets	14,133	9,782
Other income	158,884	193
	115,449	(50,883)
Income before income taxes	2,055,865	601,722
Income tax provision	775,750	218,563
Net income	\$ 1,280,115	\$ 383,159
Basic earnings per share	\$.36	\$ 0.11
Diluted earnings per share	\$.36	\$ 0.11
Weighted shares outstanding:		
Basic	3,593,966	3,640,899
Diluted	3,593,966	3,640,899

See accompanying notes to consolidated financial statements.

5.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007
(UNAUDITED)

20082007

Revenue from services	\$ 13,759,177	\$ 11,804,056
Revenue from product sales	75,673,131	43,557,599
Total Revenue	89,432,308	55,361,655
Cost of goods sold for services	12,821,444	10,769,624
Cost of goods sold for product sales	62,110,231	36,909,805
Reduction of cost of goods sold	-	(480,060)
Total Cost of goods sold	74,931,675	47,199,369
Selling, general and administrative expense	7,861,160	4,804,324
Income before other income (expense)	6,639,473	3,357,962
Other income (expense)		
Interest expense	(305,197)	(204,948)
Interest income	63,057	92,002
Gain/(loss) on sale of assets	30,614	(1,606)
Other income	287,550	22,551
	76,024	(92,001)
Income before income taxes	6,715,497	3,265,961
Income tax provision	2,686,199	1,268,423
Net income	\$ 4,029,298	\$ 1,997,538
Basic earnings per share	\$ 1.12	\$ 0.55
Diluted earnings per share	\$ 1.12	\$ 0.55
Weighted shares outstanding:		
Basic	3,602,703	3,640,899
Diluted	3,602,703	3,640,899

See accompanying notes to consolidated financial statements.

6.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
NINE MONTHS ENDED SEPTEMBER 30, 2008
(UNAUDITED)

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Treasury Stock</u>		<u>Total</u>
	<u>Shares</u>	<u>Amount</u>			<u>Shares</u>	<u>Cost</u>	
Balance as of December 31, 2007	4,295,000	\$21,475	\$3,599,624	\$9,434,733	(674,101)	\$ (1,036,394)	\$12,019,438
Stock repurchase	-	-	-	2,961	(55,607)	(530,648)	(527,687)
Stock bonus	-	-	142,749	-	10,000	18,651	161,400
Cash dividend	-	-	-	(364,190)	-	-	(364,190)
Net income	-	-	-	4,029,298	-	-	4,029,298
Balance as of September 30, 2008	4,295,000	\$21,475	\$3,742,373	\$13,102,802	(719,708)	\$ (1,548,391)	\$ 15,318,259

7

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007
(UNAUDITED)

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities		
Net income	\$ 4,029,298	\$ 1,997,538
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,575,843	1,431,764
Deferred income taxes	880,000	(99,434)
Tax benefits related to common stock options	-	210,564
(Gain)/loss on sale of property and equipment	(30,614)	1,606
Change in assets and liabilities		
Receivables	(2,069,243)	(1,865,162)

7

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

Net investment in sales-type leases	47,968	36,520
Inventories	1,843,786	(1,009,955)
Other assets	284,903	(176,826)
Accounts payable	201,692	(304,543)
Other current liabilities	2,090,954	(912,009)
Net cash from operating activities	5,167,015	(689,937)
Cash flows from investing activities		
Proceeds from sale of property and equipment	82,827	57,300
Purchases of property and equipment	(2,453,593)	(1,716,680)
Purchases for shredder system construction in progress	(2,946,360)	(1,065,510)
Payments from related party	27,155	25,706
Net cash from investing activities	(5,289,971)	(2,699,184)
Cash flows from financing activities		
Purchases of common stock	(527,687)	(198,460)
Issuance of common stock	161,400	215,800
Payments on capital lease obligation	(113,312)	(210,080)
Payment of cash dividend	(364,190)	(364,090)
Proceeds from long-term debt	6,513,703	6,350,000
Payments on long-term debt	(3,988,504)	(2,986,097)
Net cash from financing activities	1,681,410	2,807,073
Net increase/(decrease) in cash	1,558,454	(582,048)
Cash at beginning of period	1,501,685	1,331,807
Cash at end of period	\$ 3,060,139	\$ 749,759
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 305,197	\$ 204,948
Cash paid for taxes	291,214	2,235,377
Supplemental disclosure of noncash investing and financing activities:		
Equipment purchased under capital leases	-	219,889
Equipment purchased through seller financing	-	1,010,040

(Unaudited)

NOTE 1 -- BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U. S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U. S. generally accepted accounting principles for complete consolidated financial statements. The information furnished includes all adjustments, which are, in the opinion of management, necessary to present fairly our financial position as of September 30, 2008 and the results of our operations and changes in our cash flow for the periods ended September 30, 2008 and 2007. Results of operations for the period ended September 30, 2008 are not necessarily indicative of the results that may be expected for the entire year. Additional information, including the audited December 31, 2007 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, 2007 on file with the Securities and Exchange Commission.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosure about fair market value measurements. This Statement does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. For financial assets and liabilities, SFAS No. 157 is effective for us beginning January 1, 2008. In February 2008, the FASB deferred the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those as recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) until January 1, 2009. Management believes the impact will not require material modification related to our non-recurring fair value measurements and will be substantially limited to expanded disclosures in the Notes to the Financial Statements for notes that currently have components measured at fair market value.

Effective January 1, 2008 we adopted SFAS No. 157 for financial assets and liabilities measure at fair market value on a recurring basis. The partial adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on our consolidated financial position, results of operations or cash flows. See Note 10 for information and related disclosures.

NOTE 2 -- ESTIMATES

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

NOTE 3 -- LONG TERM DEBT AND NOTES PAYABLE TO BANK

We currently maintain a \$10.0 million senior revolving credit facility with the Branch Banking and Trust Company. This revolving credit facility has a three year term expiring December 22, 2009, provides for advances of up to eighty percent (80%) of our eligible accounts receivable and up to forty percent (40%) of eligible inventory, and up to one hundred percent (100%) of our net book value of eligible equipment less an outstanding indebtedness on the equipment. The revolving credit facility bears interest at the one month LIBOR rate, as published in the Wall Street Journal, plus two and twenty-five one-hundredths percent (2.25%) per annum, which was 6.25% as of September 30, 2008, and is secured by all our assets (except rental fleet equipment). The balance of the credit facility at September 30, 2008 was \$4,027,002. The revolving credit facility contains certain restrictive and financial covenants. At September 30, 2008, we were in compliance with all restrictive covenants and the entire amount of our credit facility less our outstanding borrowings was available for borrowings. On October 2, 2008, we paid \$2,000,000 to decrease the balance of the credit facility to \$2,027,002.

On August 2, 2007, we entered into an asset purchase agreement for \$1,300,000 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 \$20,000 per month for 60 months for various assets including tractor trailers, trucks and containers. The note payable reflects a seven percent (7%) interest payment on the outstanding balance plus principal amortization. We recorded a note payable of \$1,010,040 with an outstanding balance at September 30, 2008 of \$820,076.

On May 14, 2008, we executed a new loan agreement with Branch Banking and Trust Company in the amount of \$3.0 million secured by our rental fleet equipment. This note replaces the \$2.0 million rental fleet loan with Fifth Third Bank. Until October 15, 2008, indebtedness under this loan agreement accrued interest at the one month Libor rate, as published in the Wall Street Journal, plus 1.625% per annum. Fifty-nine (59) monthly principal and interest payments of \$30,966.76 commenced on June 7, 2008 with one final payment of all remaining principal and accrued interest due on May 7, 2013. Effective October 15, 2008, we converted this revolving credit facility with a variable interest rate into a fixed interest rate of 5.65% by executing a floating to fixed interest rate swap with BB&T as the counterparty to the ISDA Master Agreement, Schedule and confirmation. The maturity date under this revised agreement is May 2013. The repayment terms are principal paid in twelve (12) monthly payments of \$19,673.54 plus interest commencing on November 7, 2008 and continuing through October 7, 2009, principal paid in 12 monthly payments of \$20,835.07 plus interest commencing on November 7, 2009 and continuing through October 7, 2010; principal paid in 12 monthly payments of \$22,065.17 plus interest commencing on November 7, 2010 and continuing through October 7, 2011; principal paid in 12 monthly payments of \$23,367.89 plus interest commencing on November 7, 2011 and continuing through October 7, 2012; principal paid in six (6) monthly payments of \$24,747.53 plus interest commencing on November 7, 2012 and continuing through April 7, 2013, with one final payment of all remaining

principal and accrued interest due at maturity on May 7, 2013. The principal and interest payments of this facility are calculated on the basis of a ten (10) year amortization, resulting in a principal balance of approximately \$1.7 million due at maturity. As of September 30, 2008 we had borrowed \$2,897,114 against this loan. The terms of the loan agreement place certain restrictive covenants on us, including maintenance of a specified tangible net worth, debt to net worth and EBITDA ratio. Consequently, these covenants restrict our ability to incur as much additional debt as we may desire for future growth. At September 30, 2008, we were in compliance with all restrictive covenants.

On May 14, 2008, we executed a new loan agreement with Branch Banking and Trust Company in the amount of \$6.0 million to finance the purchase of our shredder system and complimentary facility improvements. The security for this facility is the shredder and assets being purchased. Our Board approved the acquisition and installation of the shredder system and complimentary facility improvements on June 21, 2007. The note has a term beginning May 2008 and originally expiring November 2013. Until October 15, 2008, the facility bore interest at the one month Libor rate, as published in the Wall Street Journal, plus 1.625% per annum. The facility originally provided for interest only monthly payments which commenced June 7, 2008 and continue through November 7, 2008. Effective October 15, 2008, we converted this revolving credit facility into a fixed interest rate of 5.89% by executing a floating to fixed interest rate swap with BB&T as the counterparty to the ISDA Master Agreement, Schedule and confirmation. The maturity date under this revised agreement is April 2014. The repayment terms are interest only paid in 6 monthly payments starting on November 7, 2008 and continuing through April 7, 2009; principal paid in twelve (12) monthly payments of \$37,636.11 plus interest commencing on May 7, 2009 and continuing through April 7, 2010; principal paid in 12 monthly payments of \$39,957.42 plus interest commencing on May 7, 2010 and continuing through April 7, 2011; principal paid in 12 monthly payments of \$42,421.91 plus interest commencing on May 7, 2011 and continuing through April 7, 2012; principal paid in 12 monthly payments of \$45,038.40 plus interest commencing on May 7, 2012 and continuing through April 7, 2013; principal paid in eleven (11) monthly payments of \$47,816.27 plus interest commencing on May 7, 2013 and continuing through March 7, 2014, with one final payment of all remaining principal and accrued interest due at maturity on April 7, 2014. The principal and interest payments of the facility are calculated on the basis of a ten (10) year amortization, resulting in a principal balance of approximately \$3.5 million being due on or before April 7, 2014, at which time we anticipate that we will refinance. As of September 30, 2008 we had borrowed \$3,513,703 against this loan. The terms of the loan agreement place certain restrictive covenants on us, including maintenance of a specified tangible net worth, debt to net worth and EBITDA ratio. Consequently, these covenants restrict our ability to incur as much additional debt as we may desire for future growth. At September 30, 2008, we were in compliance with all restrictive covenants.

NOTE 4 -- SEGMENT INFORMATION

Our operations include three primary segments: ISA Recycling, Computerized Waste Systems (CWS), and Waste Equipment Sales & Service (WESSCO). ISA Recycling provides products and services to meet the needs of its customers related to ferrous, non-ferrous and fiber recycling at three locations in the Midwest. CWS provides waste disposal services including contract negotiations with service providers, centralized billing, invoice auditing, and centralized dispatching. WESSCO sells, leases, and services waste handling and recycling equipment.

Our three 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 and fiber scrap; CWS's revenues consist of charges to customers for waste disposal services; and WESSCO sales and lease income comprise the primary source of revenue for this segment. The components of the column labeled "other" are selling, general and administrative expenses that are not directly related to the three primary segments.

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

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008	ISA RECYCLING	COMPUTERIZED WASTE SYSTEMS	WASTE EQUIPMENT SALES & SERVICES	OTHER	SEGMENT TOTALS
Recycling revenues	\$ 73,936,140	\$ -	\$ -	\$ -	\$73,936,140
Equipment sales, service and leasing revenues	-	-	1,736,991	-	,736,991
Management fees	-	13,759,177	-	-	13,759,177
Cost of goods sold	(61,465,322)	(12,821,444)	(644,909)	-	(74,931,675)
Selling, general and administrative expenses	(4,168,797)	(862,205)	(312,174)	(2,517,984)	(7,861,160)
Segment profit (loss)	\$ 8,302,021	\$ 75,528	\$ 779,908	(2,517,984)	\$ 6,639,473
Segment assets	\$ 25,953,912	\$ 2,196,188	\$ 1,969,974	\$ 5,047,802	\$35,167,876

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007	ISA RECYCLING	COMPUTERIZED WASTE SYSTEMS	WASTE EQUIPMENT SALES & SERVICES	OTHER	SEGMENT TOTALS
Recycling revenues	\$ 42,015,848	\$ -	\$ -	\$ -	\$ 42,015,848
Equipment sales, service and leasing revenues	-	-	1,541,751	-	1,541,751
Management fees	-	11,804,056	-	-	11,804,056
Cost of goods sold	(36,280,146)	(10,289,564)	(629,659)	-	(47,199,369)
Selling, general and administrative expenses	(1,393,658)	(981,102)	(520,397)	(1,909,167)	(4,804,324)
Segment profit (loss)	\$ 4,342,044	\$ 533,390	\$ 391,695	\$ (1,909,167)	\$ 3,357,962
Segment assets	\$ 15,713,728	\$ 3,293,727	\$ 2,224,422	\$ 3,073,152	\$ 24,305,029

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008	ISA RECYCLING	COMPUTERIZED WASTE SYSTEMS	WASTE EQUIPMENT SALES & SERVICES	OTHER	SEGMENT TOTALS
Recycling revenues	\$ 23,392,074	\$ -	\$ -	\$ -	\$23,392,074
Equipment sales, service and leasing revenues	-	-	570,375	-	570,375
Management fees	-	4,875,379	-	-	4,875,379
Cost of goods sold	(19,529,154)	(4,578,407)	(220,108)	-	(24,327,669)
Selling, general and administrative expenses	(1,386,933)	(289,499)	(105,269)	(788,042)	(2,569,743)

Segment profit (loss)	\$ 2,475,987	\$ 7,473	\$ 244,998	\$ (788,042)	\$ 1,940,416
Segment assets	\$ 25,953,912	\$ 2,196,188	\$ 1,969,974	\$ 5,047,802	\$35,167,876

	FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2007	ISA RECYCLING	COMPUTERIZED WASTE SYSTEMS	WASTE EQUIPMENT SALES & SERVICES	OTHER	SEGMENT TOTALS
Recycling revenues	\$ 13,120,062	\$ -	\$ -	\$ -	\$ -	\$ 13,120,062
Equipment sales, service and leasing revenues	-	-	-	497,195	-	497,195
Management fees	-	4,311,553	-	-	-	4,311,553
Cost of goods sold	(11,781,279)	(3,504,226)	(199,584)	-	-	(15,485,089)
Selling, general and administrative expenses	(402,237)	(435,056)	(167,553)	(786,270)	-	(1,791,116)
Segment profit (loss)	\$ 936,546	\$ 372,271	\$ 130,058	\$ (786,270)	\$ -	\$ 652,605
Segment assets	\$ 15,713,728	\$ 3,293,727	\$ 2,224,422	\$ 3,073,152	\$ -	\$ 24,305,029

NOTE 5 -- INVENTORIES

Our inventories primarily consist of ferrous and non-ferrous scrap metals and are valued at the lower of average purchased cost or market. Quantities of inventories are determined based on our inventory systems and are subject to periodic physical verification using estimation techniques including observation, weighing and other industry methods. We would recognize inventory impairment when the market value, based upon current and estimated market pricing, falls below recorded value or when the estimated volume is less than the recorded volume of the inventory. We would record the loss in cost of goods sold in the period during which we identified the loss.

Some commodities are in saleable condition at acquisition. We purchase these commodities in small amounts until we have a truckload of material available for shipment. Some commodities are not in saleable condition at acquisition. These commodities must be 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. Ferrous inventory of \$3,442,386 at September 30, 2008 was comprised of \$1,280,825 in raw materials and \$2,161,561 of finished goods. Non-ferrous inventory of \$2,862,115 at September 30, 2008 was comprised of \$910,150 in raw materials and \$1,951,965 of finished goods. Ferrous inventory of \$1,848,445 at December 31, 2007 was comprised of \$686,332 in raw materials and \$1,162,113 of finished goods. Non-ferrous inventory of \$2,715,703 at December 31, 2007 was comprised of \$372,949 in raw materials and \$2,342,754 of finished goods. We charged \$2,358,075 in general and administrative processing costs to cost of sales for the quarter ended September 30, 2008 and \$2,671,089 for the year ended December 31, 2007.

Inventory also includes all types of industrial waste handling equipment and machinery held for resale such as compactors, balers, and containers. Other inventory includes cardboard and baling wire. Inventories as of September 30, 2008 and December 31, 2007 consist of the following:

	September 30, 2008 (unaudited)	December 31, 2007
Ferrous materials	\$ 3,442,386	\$ 1,848,445
Non-ferrous materials	2,862,115	2,715,703
Waste equipment machinery	75,750	36,498
Other	90,816	26,635
 Total inventories	 \$ 6,471,067	 \$ 4,627,281

NOTE 6 - 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 agreement to monthly payments of \$48,500 through December 2012. In addition, we are also responsible for real estate taxes, insurance, utilities and maintenance expense.

We also lease a management services operations facility and various pieces of equipment in Dallas, Texas for which monthly payments of \$969 are due through September 2009.

We also lease other machinery and equipment under operating leases which expire through July 2009.

Future minimum lease payments for operating leases as of September 30, 2008 are as follows:

2008	\$ 702,510
2009	636,000
2010	636,000

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

2011	636,000
2012	159,000
Future minimum lease payments	\$ 2,769,510

Total rent expense for the nine months ended September 30, 2008 and 2007 was \$661,111 and \$637,741, respectively.

Capital Leases:

We lease various pieces of equipment which qualify as capital leases. These lease arrangements require monthly lease payments expiring at various dates through June 2010.

The following is a summary of assets held under capital leases which are included in property and equipment:

	<u>2008</u>	<u>2007</u>
Equipment	\$ 771,567	\$ 1,269,222
Less accumulated depreciation	242,418	254,894
	\$ 529,149	\$ 1,014,328

The following is a schedule of future annual minimum lease payments under the capitalized lease arrangements, together with the present value of net minimum lease payments at September 30, 2008.

2008	\$ 81,451
2009	40,481
Total future minimum lease payments	121,932
Less amount representing interest	-
Present value of net minimum lease payments	121,932
Less current portion	(81,451)
Capital Lease Obligations	\$ 40,481

NOTE 7 -- PER SHARE DATA

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

Nine months ended September 30, 2008 compared to nine months ended September 30, 2007:

	<u>2008</u>	<u>2007</u>
Basic earnings per share		
Net income	\$ 4,029,298	\$ 1,997,538
Weighted average shares outstanding	3,602,703	3,640,899
Basic earnings per share	\$ 1.12	\$.55
Diluted earnings per share		
Net income	\$ 4,029,298	\$ 1,997,538
Weighted average shares outstanding	3,602,703	3,640,899
Add dilutive effect of assumed exercising of stock options	-	-
Diluted weighted average shares outstanding	3,602,703	3,640,899
Diluted earnings per share	\$ 1.12	\$.55

Three months ended September 30, 2008 compared to three months ended September 30, 2007:

Basic earnings per share		
Net income	\$ 1,280,115	\$ 383,159
Weighted average shares outstanding	3,593,966	3,640,899
Basic earnings per share	\$.36	\$.11
Diluted earnings per share		
Net income	\$ 1,280,115	\$ 383,159
Weighted average shares outstanding	3,593,966	3,640,899
Add dilutive effect of assumed exercising of stock options	-	-
Diluted weighted average shares outstanding	3,593,966	3,640,899
Diluted earnings per share	\$.36	\$.11

NOTE 8 -- SHREDDER SYSTEM COMMITMENT

We have made a total commitment of ten million dollars to build a state-of-the-art shredding and nonferrous recovery system. The Board of Directors, at its June 21, 2007 meeting, announced authorization to proceed with the purchase of a shredder system and complimentary facility improvement totaling five million dollars. Commitments of an additional five million dollars include the purchase of a nonferrous recovery system, modifications to the original contract of the shredder system, additional facility improvements including second entrance and scales, and installation costs. On July 30, 2007, we entered into a contract with The Shredder Company located in Canutillo, Texas to purchase a shredder system. The shredder will shred ferrous and non ferrous scrap for domestic and international consumers. The shredder can also be used for a disaster plan by handling materials prior to landfill disposal and recycling purposes. Through September 30, 2008, we made payments to The Shredder Company and other vendors totaling \$5,119,436 classified as construction in progress. Construction on the shredder began June

2008. We are financing the purchase of the shredder system with our loan with BB&T. As of September 30, 2008, we had incurred capitalized interest of \$160,630. This project is scheduled to be completed by the end of February 2009.

NOTE 9 -- PROPERTY PURCHASE

On September 2, 2008, we announced our continuing expansion in Louisville, Kentucky with the purchase of the former Allied System truck terminal for \$1,190,000. The 20,182 square foot facility sits on 4.4 acres of asphalted parking area. Located in the Renaissance Zone, the property will be occupied by ISA Logistics and Waste Equipment Sales and Service Company (WESSCO), relocating from the main Louisville location, and creating room for the shredder system and related maintenance equipment. We are committed, with the City of Louisville, to the continued growth and development of the Renaissance Zone, and with a related party, own almost 60 acres of mixed use land and buildings within the Zone. Our new geographical expansion includes two recycling facilities in New Albany and Seymour, Indiana.

NOTE 10 -- FAIR VALUE MEASUREMENTS

Effective January 1, 2008, we adopted SFAS No. 157, Fair Value Measurements, for financial assets and liabilities. This standard defines fair value, provides guidance for measuring fair value and requires certain disclosures. This standard does not require any new fair market value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost). The statement utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1 Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 Observable inputs other than quoted prices for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3 Unobservable inputs that reflect our own assumptions.

We use the fair value methodology outlined in SFAS 157 to value the assets and liabilities for cash and debt. All of our cash and debt are defined as Level 1. In accordance with SFAS 157, the following table represents our fair value hierarchy for financial instruments at September 30, 2008:

	Level 1	Total
Assets		
Cash and cash equivalents	\$ 3,060,139	\$ 3,060 139
Liabilities		
Long term debt	\$ (11,257,896)	\$ (11,257,896)

NOTE 11 -- STOCK AWARD

Mr. Brian Donaghy, our President and Chief Operating Officer is entitled to receive 20,000 shares of ISA's common stock per year per the terms of his employment agreement, provided certain conditions have been met, including that Mr. Donaghy has completed a full year of employment and that our EBITDA exceeds \$4.5 million for the previous fiscal year. During 2008, the conditions of the agreement for the year 2008 were determined probable that they would be met. Accordingly, we were accruing the share based award over the requisite period.

At a regular scheduled Board meeting on July 31, 2008, the directors approved the issuance of 10,000 shares of ISA's common stock to Brian Donaghy. The directors also approved the issuance of the remaining 10,000 shares which are to be paid equally in the third and fourth quarter at dates to be specified by the Board. We paid 10,000 shares to Mr. Donaghy in August 2008 for the first two quarters of 2008. We accrued \$51,250 in the third quarter for the third quarter stock award.

ITEM 2: MANAGEMENT'S 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, a significant downturn in the economy

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, 2007, as filed with the Securities and Exchange Commission.

General

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

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 2,300 customer locations throughout the United States and we utilize an active database of over 6,600 vendors to provide timely, thorough and cost-effective service to our customers.

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

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

Liquidity and Capital Resources

As of September 30, 2008 we held cash and cash equivalents of \$3,060,139.

We currently maintain a \$10.0 million senior revolving credit facility with the Branch Banking and Trust Company. This revolving credit facility has a three year term expiring December 22, 2009, provides for advances of up to eighty percent (80%) of our eligible accounts receivable and up to forty percent (40%) of eligible inventory, and up to one hundred percent (100%) of our net book value of eligible equipment less an outstanding indebtedness on the equipment. The revolving credit facility bears interest at the one month LIBOR rate, as published in the Wall Street

Journal, plus two and twenty-five one-hundredths percent (2.25%) per annum, which was 6.25% as of September 30, 2008, and is secured by all our assets (except rental fleet equipment). The balance of the credit facility at September 30, 2008 was \$4,027,002. The revolving credit facility contains certain restrictive and financial covenants. At September 30, 2008, we were in compliance with all restrictive covenants and the entire amount of our credit facility less our outstanding borrowings was available for borrowings. On October 2, 2008 we paid \$2,000,000 to decrease the balance of the credit facility to \$2,027,002.

On August 2, 2007, we entered into an asset purchase agreement for \$1,300,000 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 \$20,000 per month for 60 months for various assets including tractor trailers, trucks and containers. The note payable reflects a seven percent (7%) interest payment on the outstanding balance plus principal amortization. We recorded a note payable of \$1,010,040 with an outstanding balance at September 30, 2008 of \$820,076.

On May 14, 2008, we executed a new loan agreement with Branch Banking and Trust Company in the amount of \$3.0 million secured by our rental fleet equipment. This note replaces the \$2.0 million rental fleet loan with Fifth Third Bank. Until October 15, 2008, indebtedness under this loan agreement accrued interest at the one month Libor rate, as published in the Wall Street Journal, plus 1.625% per annum. Fifty-nine (59) monthly principal and interest payments of \$30,966.76 commenced on June 7, 2008 with one final payment of all remaining principal and accrued interest due on May 7, 2013. Effective October 15, 2008, we converted this revolving credit facility with a variable interest rate into a fixed interest rate of 5.65% by executing a floating to fixed interest rate swap with BB&T as the counterparty to the ISDA Master Agreement, Schedule and confirmation. The maturity date under this revised agreement is May 2013. The repayment terms are principal paid in twelve (12) monthly payments of \$19,673.54 plus interest commencing on November 7, 2008 and continuing through October 7, 2009, principal paid in 12 monthly payments of \$20,835.07 plus interest commencing on November 7, 2009 and continuing through October 7, 2010; principal paid in 12 monthly payments of \$22,065.17 plus interest commencing on November 7, 2010 and continuing through October 7, 2011; principal paid in 12 monthly payments of \$23,367.89 plus interest commencing on November 7, 2011 and continuing through October 7, 2012; principal paid in six (6) monthly payments of \$24,747.53 plus interest commencing on November 7, 2012 and continuing through April 7, 2013, with one final payment of all remaining principal and accrued interest due at maturity on May 7, 2013. The principal and interest payments of this facility are calculated on the basis of a ten (10) year amortization, resulting in a principal balance of approximately \$1.7 million due at maturity. As of September 30, 2008 we had borrowed \$2,897,114 against this loan. The terms of the loan agreement place certain restrictive covenants on us, including maintenance of a specified tangible net worth, debt to net worth and EBITDA ratio. Consequently, these covenants restrict our ability to incur as much additional debt as we may desire for future growth. At September 30, 2008, we were in compliance with all restrictive covenants.

On May 14, 2008, we executed a new loan agreement with Branch Banking and Trust Company in the amount of \$6.0 million to finance the purchase of our shredder system and complimentary facility improvements. The security for this facility is the shredder and assets being purchased. Our Board approved the acquisition and installation of the shredder system and complimentary facility improvements on June 21, 2007. The note has a term beginning May 2008 and originally expiring November 2013. Until October 15, 2008, the facility bore interest at the one month Libor rate, as published in the Wall Street Journal, plus 1.625% per annum. The facility originally provided for interest only monthly payments which commenced June 7, 2008 and continue through November 7, 2008. Effective October 15, 2008, we converted this revolving credit facility into a fixed interest rate of 5.89% by executing a floating to fixed interest rate swap with BB&T as the counterparty to the ISDA Master Agreement, Schedule and confirmation. The maturity date under this revised agreement is April 2014. The repayment terms are interest only

paid in 6 monthly payments starting on November 7, 2008 and continuing through April 7, 2009; principal paid in twelve (12) monthly payments of \$37,636.11 plus interest commencing on May 7, 2009 and continuing through April 7, 2010; principal paid in 12 monthly payments of \$39,957.42 plus interest commencing on May 7, 2010 and continuing through April 7, 2011; principal paid in 12 monthly payments of \$42,421.91 plus interest commencing on May 7, 2011 and continuing through April 7, 2012; principal paid in 12 monthly payments of \$45,038.40 plus interest commencing on May 7, 2012 and continuing through April 7, 2013; principal paid in eleven (11) monthly payments of \$47,816.27 plus interest commencing on May 7, 2013 and continuing through March 7, 2014, with one final payment of all remaining principal and accrued interest due at maturity on April 7, 2014. The principal and interest payments of the facility are calculated on the basis of a ten (10) year amortization, resulting in a principal balance of approximately \$3.5 million being due on or before April 7, 2014, at which time we anticipate that we will refinance. As of September 30, 2008 we had borrowed \$3,513,703 against this loan. The terms of the loan agreement place certain restrictive covenants on us, including maintenance of a specified tangible net worth, debt to net worth and EBITDA ratio. Consequently, these covenants restrict our ability to incur as much additional debt as we may desire for future growth. At September 30, 2008, we were in compliance with all restrictive covenants.

During the first three quarters of 2008, we paid \$2,453,593 for land, improvements, property and equipment. We paid \$1,190,000 for the land and building at 6709 Grade Lane. We paid \$135,579 for other buildings and improvements. In the recycling segment we paid \$414,073 for cranes, a forklift, shear rebuild, scales, trailers, grapple and other operating equipment. In the equipment sales, leasing and service segment, we purchased \$458,374 in rental equipment that we located at customer sites. This rental fleet equipment consists of solid waste handling and recycling equipment such as compactors, pre-crushers, containers and balers. It is our intention to continue to pursue this market. We purchased \$50,760 of office equipment and \$204,807 in vehicles.

We have a purchasing card with a credit limit of \$6.0 million. We included the balance due on the purchasing card as part of accounts payable. The outstanding balance on the purchasing card at September 30, 2008 was \$777,389 with a due date of October 27, 2008. The card accrues interest at prime plus 5.9% after the first twenty-five days of the purchase; our intention is to pay off the full balance every month so as to not incur finance charges. To date we have not incurred any interest charges on this purchasing card. The card requires monthly minimum payments on any balance outstanding at month end. We receive rebates on an annual basis for all purchases made with the card.

We expect that existing cash flow from operations and available credit under our existing credit facilities will be sufficient to meet our cash needs during the remainder of 2008.

Results of Operations

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

	<u>Nine months ended</u>	
	<u>September 30,</u>	
	<u>2008</u>	<u>2007</u>
Statements of Operations Data:		
Total Revenue	100.0%	100.0%
Cost of goods sold.....	83.8%	85.2%
Selling, general and administrative expenses	8.8%	8.7%
Income before other expenses.....	7.4%	6.1%

Nine months ended September 30, 2008 compared to nine months ended September 30, 2007

Total revenue increased \$34,070,653 or 61.5% to \$89,432,308 in 2008 compared to \$55,361,655 in 2007. Recycling revenue increased \$31,920,292 or 76.0% to \$73,936,140 in 2008 compared to \$42,015,848 in 2007. This is primarily due to a 43% increase in price of commodities in the recycling market and a 14% increase in volume of shipments. Management services revenue increased \$1,955,121 or 16.6% to \$13,759,177 in 2008 compared to \$11,804,056 in 2007 primarily due to an increase in the number of customer locations managed. Equipment sales, service and leasing revenue increased \$195,240 or 12.7% to \$1,736,991 in 2008 compared to \$1,541,751 in 2007. This increase is due to an increase in rental revenue because of more equipment rentals and an increase in equipment sales.

Total cost of goods sold increased \$27,732,306 or 58.8% to \$74,931,675 in 2008 compared to \$47,199,369 in 2007. Recycling cost of goods sold increased \$25,185,176 or 69.4% to \$61,465,322 in 2008 compared to \$36,280,146 in 2007. This is primarily due to a 25% higher volume of purchases in the recycling market. Management services cost of goods sold increased \$2,531,880 or 24.6% to \$12,821,444 in 2008 compared to \$10,289,564 in 2007 primarily due to an increase in the number of customer locations managed. Additionally, we reduced cost of goods sold by \$0 in 2008 and by \$480,060 in 2007 due to a change in management's estimate related to the liability associated with this operation which includes the contract settlement with our former customers. Equipment sales, service and leasing cost of goods sold increased \$15,250 or 2.4% to \$644,909 in 2008 compared to \$629,659 in 2007.

Selling, general and administrative expenses increased \$3,056,836 or 63.6% to \$7,861,160 in 2008 compared to \$4,804,324 in 2007. As a percentage of revenue, selling, general and administrative expenses were 8.8% in 2008 compared to 8.7% in 2007. The primary driver of the increase in total expenses is an increase in ISA Logistics expenses of \$1.8 million, Sarbanes Oxley expense of \$108,830 and rising fuel expenditures. We acquired ILS in August 2007.

Other income/(expense) increased \$168,025 to other income of \$76,024 in 2008 compared to other expense of \$(92,001) in 2007. This was primarily due to the reduction of accounts payable of \$156,400 and other income of \$117,306 due to an insurance reimbursement.

Income tax provision increased \$1,417,776 to \$2,686,199 in 2008 compared to \$1,268,423 in 2007. The effective tax rate in 2008 was 40.0% compared to 38.8% in 2007 based on federal and state statutory rates.

Three months ended September 30, 2008 compared to three months ended September 30, 2007

Total revenue increased \$10,909,018 or 60.8 % to \$28,837,828 in 2008 compared to \$17,928,810 in 2007. Recycling revenue increased \$10,272,012 or 78.3% to \$23,392,074 in 2008 compared to \$13,120,062 in 2007. This is primarily due to a 55% increase in price of commodities in the recycling market. Management services revenue increased \$563,826 or 13.1% to \$4,875,379 in 2008 compared to \$4,311,553 in 2007 primarily due to an increase in the number of customer locations managed. Equipment sales, service and leasing revenue increased \$73,180 or 14.7% to \$570,375 in 2008 compared to \$497,195 in 2007. This increase is due to an increase in rental revenue because of more equipment rentals and an increase in equipment sales.

Total cost of goods sold increased \$8,842,580 or 57.1% to \$24,327,669 in 2008 compared to \$15,485,089 in 2007. Recycling cost of goods sold increased \$7,747,875 or 65.8% to 19,529,154 in 2008 compared to \$11,781,279 in 2007. This is due to 2% higher commodity purchase prices in the recycling market and a 40% increase in the volume of purchases. Management services cost of goods sold increased \$1,074,181 or 30.7% to \$4,578,407 in 2008 compared to \$3,504,226 in 2007 primarily due to an increase in the number of customer locations managed. Additionally, we reduced cost of goods sold by \$337,516 in 2007 due to a change in management's estimate related to the liability associated with this operation, which includes the contract settlement with our former customers. Equipment sales, service and leasing cost of goods sold increased \$20,524 to \$220,108 in 2008 compared to \$199,584 in 2007.

Selling, general and administrative expenses increased \$778,627 or 43.5% to \$2,569,743 in 2008 compared to \$1,791,116 in 2007. As a percentage of revenue, selling, general and administrative expenses were 8.9% in 2008 compared to 10% in 2007. The primary driver of the increase in total expense is ILS expenses, Sarbanes Oxley expenditures and fuel costs. We acquired ILS in August 2007.

Other income/(expense) increased \$166,332 to other income of \$115,449 in 2008 compared to other expense of (\$50,883) in 2007 primarily due to the reduction of accounts payable of \$156,400.

Income tax provision increased \$557,187 to \$775,750 in 2008 compared to \$218,563 in 2007. The effective tax rate in 2008 was 37.7% compared to 36.3% in 2007 based on federal and state statutory rates.

Financial condition at September 30, 2008 compared to December 31, 2007

Cash and cash equivalents increased \$1,558,454 to \$3,060,139 as of September 30, 2008 compared to \$1,501,685 as of December 31, 2007.

We generated net cash from operating activities of \$5,167,015 for the nine months ended September 30, 2008 due to net income of \$4.0 million and increases in current liabilities and deferred taxes.

We used net cash from investing activities of \$5,289,971 for the nine months ended September 30, 2008. Primarily, we purchased recycling and rental fleet equipment and shredder system equipment of \$5,399,953. The rental fleet equipment consists of solid waste handling and recycling equipment such as compactors, containers and balers. It is our intention to continue to pursue this market.

Our net cash from financing activities of \$1,681,410 for the nine months ended September 30, 2008 is primarily due to the advance of \$6,513,703 on our new lines of credit offset by payments on debt of \$3,988,504.

Accounts receivable trade increased \$2,069,243 or 30.6% to \$8,834,094 as of September 30, 2008 compared to \$6,764,851 as of December 31, 2007. This change is primarily due to an increase in selling prices in the recycling segment.

Inventories consist principally of ferrous and nonferrous scrap materials and waste equipment machinery held for resale. We value inventory at the lower of cost or market. Inventory increased \$1,843,786 or 39.9% to \$6,471,067 as of September 30, 2008 compared to \$4,627,281 as of December 31, 2007.

We have recognized an inventory impairment of \$25,123 for the third quarter ending September 30, 2008, based on the value of our inventories to the lower of average purchased cost or market. We have lowered our manufacturing activity. We are not currently offering our inventory for sale in the present market as we believe from a historical perspective that the market will see some improvement as we believe the supply of scrap material is limited. We believe we have the financial resources to withstand the present market conditions. We are looking forward to the opportunity to build our inventories for shredder processing at attractive prices.

Inventory aging for the period ended September 30, 2008 (Days Outstanding):

Description	1-30	31-60	61-90	Over 90	Total
Waste equipment machinery	\$ 75,750	\$ -	\$ -	\$ -	\$ 75,750
Ferrous materials	2,400,791	1,003,721	-	37,874	3,442,386
Non-ferrous materials	1,760,840	394,321	325,275	381,679	2,862,115
Other	90,816	-	-	-	90,816

\$4,328,197 \$1,398,042 \$ 325,275 \$ 419,553 \$6,471,067

Inventory aging for the year ended December 31, 2007 (Days Outstanding):

Description	1-30	31-60	61-90	Over 90	Total
Waste equipment machinery	\$ 36,498	\$ -	\$ -	\$ -	\$ 36,498
Ferrous Materials	1,163,306	566,774	78,183	40,182	1,848,445
Non-ferrous materials	1,885,783	553,049	129,552	147,319	2,715,703
Other	26,635	-	-	-	26,635
	\$3,112,222	\$1,119,823	\$ 207,735	\$ 187,501	\$4,627,281

Accounts payable trade increased \$201,692 or 4.4% to \$4,867,323 as of September 30, 2008 compared to \$4,665,631 as of December 31, 2007, primarily due to market conditions.

Working capital increased \$2,850,303 to \$10,790,343 as of September 30, 2008 compared to \$7,940,040 as of December 31, 2007. The increase was primarily driven by the \$2.0 million increase in accounts receivable, the \$1.8 million increase in inventories and the \$1.6 million increase in cash, offset by the \$1.5 million in income tax payable.

Contractual Obligations

The following table provides information with respect to our known contractual obligations for the quarter ended September 30, 2008.

Obligation Description	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt Obligations (1)	\$11,257,896	\$440,876	\$8,496,259	\$2,320,761	\$0
Capital Lease Obligations (2)	121,932	81,451	40,481	0	0
Operating Lease Obligations (3)	<u>2,769,510</u>	<u>702,510</u>	<u>1,272,000</u>	<u>795,000</u>	<u>0</u>
Total	\$14,149,338	\$ 1,224,837	\$9,808,740	\$3,115,761	\$0

(1) We currently maintain a \$10.0 million senior revolving credit facility with the Branch Banking and Trust Company. This revolving credit facility has a three year term expiring December 22, 2009, provides for advances of up to eighty percent (80%) of our eligible accounts receivable and up to forty percent (40%) of eligible inventory, and up to one hundred percent (100%) of our net book value of eligible equipment less an outstanding indebtedness on the equipment. The revolving credit facility bears interest at the one month LIBOR rate, as published in the Wall Street Journal, plus two and twenty-five one-hundredths percent (2.25%) per annum, which was 6.25% as of September 30, 2008, and is secured by all our assets (except rental fleet equipment). The balance of the credit facility at September 30, 2008 was \$4,027,002. The revolving credit facility contains certain restrictive and financial covenants. At September 30, 2008, we were in compliance with all restrictive covenants and the entire amount of our credit facility less our outstanding borrowings was available for borrowings. On October 2, 2008 we paid \$2,000,000 to decrease the balance of the credit facility to \$2,027,002.

On August 2, 2007, we entered into an asset purchase agreement for \$1,300,000 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 \$20,000 per month for 60 months for various assets including tractor trailers, trucks and containers. The note payable reflects a seven percent (7%) interest payment on the outstanding balance plus principal amortization. We recorded a note payable of \$1,010,040 with an outstanding balance at September 30, 2008 of \$820,076.

On May 14, 2008, we executed a new loan agreement with Branch Banking and Trust Company in the amount of \$3.0 million secured by our rental fleet equipment. This note replaces the \$2.0 million rental fleet loan with Fifth Third Bank. Until October 15, 2008, indebtedness under this loan agreement accrued interest at the one month Libor rate, as published in the Wall Street Journal, plus 1.625% per annum. Fifty-nine (59) monthly principal and interest payments of \$30,966.76 commenced on June 7, 2008 with one final payment of all remaining principal and accrued interest due on May 7, 2013. Effective October 15, 2008, we converted this revolving credit facility with a variable interest rate into a fixed interest rate of 5.65% by executing a floating to fixed interest rate swap with BB&T as the counterparty to the ISDA Master Agreement, Schedule and confirmation. The maturity date under this revised

agreement is May 2013. The repayment terms are principal paid in twelve (12) monthly payments of \$19,673.54 plus interest commencing on November 7, 2008 and continuing through October 7, 2009, principal paid in 12 monthly payments of \$20,835.07 plus interest commencing on November 7, 2009 and continuing through October 7, 2010; principal paid in 12 monthly payments of \$22,065.17 plus interest commencing on November 7, 2010 and continuing through October 7, 2011; principal paid in 12 monthly payments of \$23,367.89 plus interest commencing on November 7, 2011 and continuing through October 7, 2012; principal paid in six (6) monthly payments of \$24,747.53 plus interest commencing on November 7, 2012 and continuing through April 7, 2013, with one final payment of all remaining principal and accrued interest due at maturity on May 7, 2013. The principal and interest payments of this facility are calculated on the basis of a ten (10) year amortization, resulting in a principal balance of approximately \$1.7 million due at maturity. As of September 30, 2008 we had borrowed \$2,897,114 against this loan. The terms of the loan agreement place certain restrictive covenants on us, including maintenance of a specified tangible net worth, debt to net worth and EBITDA ratio. Consequently, these covenants restrict our ability to incur as much additional debt as we may desire for future growth. At September 30, 2008, we were in compliance with all restrictive covenants.

On May 14, 2008, we executed a new loan agreement with Branch Banking and Trust Company in the amount of \$6.0 million to finance the purchase of our shredder system and complimentary facility improvements. The security for this facility is the shredder and assets being purchased. Our Board approved the acquisition and installation of the shredder system and complimentary facility improvements on June 21, 2007. The note has a term beginning May 2008 and originally expiring November 2013. Until October 15, 2008, the facility bore interest at the one month Libor rate, as published in the Wall Street Journal, plus 1.625% per annum. The facility originally provided for interest only monthly payments which commenced June 7, 2008 and continue through November 7, 2008. Effective October 15, 2008, we converted this revolving credit facility into a fixed interest rate of 5.89% by executing a floating to fixed interest rate swap with BB&T as the counterparty to the ISDA Master Agreement, Schedule and confirmation. The maturity date under this revised agreement is April 2014. The repayment terms are interest only paid in 6 monthly payments starting on November 7, 2008 and continuing through April 7, 2009; principal paid in twelve (12) monthly payments of \$37,636.11 plus interest commencing on May 7, 2009 and continuing through April 7, 2010; principal paid in 12 monthly payments of \$39,957.42 plus interest commencing on May 7, 2010 and continuing through April 7, 2011; principal paid in 12 monthly payments of \$42,421.91 plus interest commencing on May 7, 2011 and continuing through April 7, 2012; principal paid in 12 monthly payments of \$45,038.40 plus interest commencing on May 7, 2012 and continuing through April 7, 2013; principal paid in eleven (11) monthly payments of \$47,816.27 plus interest commencing on May 7, 2013 and continuing through March 7, 2014, with one final payment of all remaining principal and accrued interest due at maturity on April 7, 2014. The principal and interest payments of the facility are calculated on the basis of a ten (10) year amortization, resulting in a principal balance of approximately \$3.5 million being due on or before April 7, 2014. November 7, 2013, at which time we anticipate that we will refinance. As of September 30, 2008 we had borrowed \$3,513,703 against this loan. The terms of the loan agreement place certain restrictive covenants on us, including maintenance of a specified tangible net worth, debt to net worth and EBITDA ratio. Consequently, these covenants restrict our ability to incur as much additional debt as we may desire for future growth. At September 30, 2008, we were in compliance with all restrictive covenants.

(2) We lease various pieces of equipment that qualify for capital lease treatment. These lease arrangements require monthly lease payments expiring at various dates through June 2010.

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

We also lease a management services operations facility and various pieces of equipment in Dallas, Texas for which monthly payments of \$969 are due through September 2009.

Long-term debt increased \$2,423,236 or 28.9% to \$10,817,020 as of September 30, 2008 compared to \$8,393,784 as of December 31, 2007.

Impact of Recently Issued Accounting Standards

The Financial Accounting Standards Board has published SFAS No. 157, Fair Value Measurements, to eliminate the diversity in practice that exists due to the different definitions of fair value and the limited guidance for applying those definitions in GAAP that are dispersed among the many accounting pronouncements that require fair value measurements. SFAS No. 157 defines fair value 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 (an exit price). SFAS No. 157 also stipulates that, as a market-based measurement, fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability, and establishes a fair value hierarchy that distinguishes between (a) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (b) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs).

SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, although earlier application is encouraged. Additionally, prospective application of the provisions of SFAS No. 157 is required as of the beginning of the fiscal year in which it is initially applied, except when certain circumstances require retrospective application. Our adoption of this standard at January 1, 2008 did not have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). SFAS 159 provides companies with an option to report selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. SFAS 159 is effective for fiscal years beginning after November 15, 2007, the year beginning January 1, 2008 for us. While we continue to review the provisions of SFAS 159, we have not yet identified any assets or liabilities for which we currently believe we will elect the fair value

reporting option.

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 certain 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 interest rate risk on our floating rate borrowings. As of September 30, 2008, our variable rate borrowings consisted of outstanding borrowings of \$4.0 million under our credit agreement with BB&T. This revolving credit facility bears interest at the one month LIBOR rate, as published in the Wall Street Journal, plus two and twenty-five one-hundredths percent (2.25%) per annum. Any increase in this rate would lead to higher interest expense. Based on our average anticipated borrowings under our credit agreement in fiscal 2008, a hypothetical increase or decrease in the LIBOR rate by 1% would increase or decrease interest expense on our variable borrowings by approximately \$20,270 per year, with a corresponding change in cash flows.

ITEM 4(T): CONTROLS AND PROCEDURES

(a) Disclosure controls and procedures.

ISA's management, including ISA's principal executive officer and principal financial officer, have evaluated the effectiveness of our "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934. Based upon their evaluation, our principal executive officer and principal financial officer concluded that, as of September 30, 2008, ISA's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that ISA files under the Exchange Act with the Securities and Exchange Commission (1) is recorded, processed, summarized and reported within the time periods specific in the SEC's rules and forms, and (2) is accumulated and communicated to ISA's management, including our principal executive and principal financial officers, as appropriate, to allow timely decisions regarding the required disclosure.

(b) Internal controls over financial reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act). Our internal control over financial

reporting is designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation and fair presentation of published financial statements for external purposes in accordance with generally accepted accounting principles in the United States.

Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets;

- provide reasonable assurance that our transactions are recorded as necessary to permit preparation of our financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

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

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

Our management conducted an evaluation of the effectiveness of our internal control over financial reporting, based on the framework and criteria established in Internal Control -- Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management assessed the effectiveness of our internal control over financial reporting for the quarter ended September 30, 2008, and concluded that such internal control over financial reporting was effective as of September 30, 2008.

(c) Changes to internal control over financial reporting

There were no changes in ISA's internal control over financial reporting during the three months ended September 30, 2008 that have materially affected, or are reasonably likely to affect ISA's internal control over financial reporting.

PART II -- OTHER INFORMATION

Item 1. Legal Proceedings

In May 2006, All American Recycling ("AAR") and its owners, R.D. Burton and Donna Burton filed a lawsuit in Jefferson County, Kentucky Circuit Court against us and K & R Resources LLC (All American Recycling, Inc. and RD Burton and Donna Burton vs. Industrial Services of America, Inc. et al. Jefferson Circuit Court, Case No. 06C04701). In May 2007 AAR amended its complaint to identify Harry Kletter, Brian Donaghy, Ronald Kletter and Edward List as individual defendants in this action. The causes of action alleged against us and the individual defendants include breach of contract, misrepresentation, fraud, malicious, willful and reckless conduct and trespass. The dispute arises from two agreements that were entered into by the parties in December 2004 (in settlement of a prior litigation between ISA and AAR). One of the two agreements called for certain "retail customers" to be referred to AAR. AAR, in turn, agreed to then sell all of its non-ferrous metals to us based on a certain agreed pricing schedule. AAR alleges that we breached the agreement by not referring such retail customers to AAR and paid AAR on a basis other than the basis provided in the agreement. We claim that we paid AAR on the basis provided for in the agreement and that AAR breached the agreement by selling its metals to third party purchasers. No specific amount of damages was set forth in the complaint, however AAR is claiming it is owed in excess of \$2,000,000. Plaintiff filed a motion for summary judgment against us on February 27, 2008 to which we responded on March 21, 2008. The court denied this motion in August 2008. Mediation failed to yield an agreement and the court has set a new trial date for early January 2009.

In January of 2007 Lennox Industries commenced an action against ISA in Lennox Industries, Inc. vs. Industrial Services of America, Inc. (Circuit Court of Arkansas County CV-2007-004). Lennox alleges that we mis-categorized certain materials that we brokered on behalf of Lennox generating less for those materials than they were worth thereby depriving Lennox of income that it might otherwise have received. Lennox alleges that we had a duty to obtain a price that was consistent with the materials being sold on behalf of Lennox and that we failed to exercise the proper duty of care in our dealings with Lennox. On July 9, 2008, Lennox amended its complaint to add a cause of action based on fraud and misrepresentation. The amended complaint does not state a specific amount of damages. We believe Lennox's claims are without merit. The case is currently in the discovery phase and is scheduled for trial December 3, 2008.

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, 2007, as filed with the Securities and Exchange Commission on March 31, 2008.

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

On November 15, 2005, our Board of Directors authorized a new program to repurchase up to 200,000 shares of our common stock at current market prices. During 2008, we repurchased 55,607 shares. In 2007 we repurchased 40,000 shares, in 2006 we repurchased 5,509 shares and in 2005 we repurchased 10,000 shares.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as part of Publicly Announced Plans or Programs	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
Oct-05	-			
Nov-05	10,000	\$ 2.9762	10,000	190,000
Dec-05	-			
Jan-06	5,509	\$ 2.9658	15,509	184,491
Aug-07	20,000	\$ 9.9229	35,509	164,491
Dec-07	20,000	\$ 7.7257	55,509	144,491
Mar-08	19,753	\$ 8.2823	75,262	124,738
Jun-08	9,854	\$ 11.4169	85,116	114,884
Sept-08	26,000	\$ 9.7902	111,116	88,884

Item 3. Defaults upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Contractual Obligations

Item 5. Other Information

None.

Item 6. Exhibits

See exhibit index.

SIGNATURES

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

INDUSTRIAL SERVICES OF AMERICA, INC.

Date: November 5, 2008

/s/ Harry Kletter
Chairman and Chief Executive Officer
(Principal Executive and Financial
Officer)

Date: November 5, 2008

/s/ Alan L. Schroering
Chief Financial Officer

INDEX TO EXHIBITS

<u>Exhibit Number</u>	<u>Description of Exhibits</u>
10.1	Note Modification Agreement, dated October 15, 2008, in the amount of \$2,897,114.77 from Industrial Services of America, Inc. in favor of Branch Banking and Trust Company of North Carolina.
10.2	Note Modification Agreement, dated October 15, 2008, in the amount of \$6,000,000 from Industrial Services of America, Inc. in favor of Branch Banking and Trust Company of North Carolina.
10.3	ISDA Master Agreement and Schedule, dated as December 22, 2006, between Industrial Services of America, Inc. and Branch Banking and Trust Company.
10.4	Swap Confirmation, dated October 20, 2008, between Industrial Services of America, Inc. and Branch Banking and Trust Company in the notional amount of \$2,897,114.77.
10.5	Swap Confirmation, dated October 20, 2008, between Industrial Services of America, Inc. and Branch Banking and Trust Company in the notional amount of \$6,000,000.
31.1	Rule 13a-14(a) Certification of Harry Kletter for the Form 10-Q for the quarter ended September 30, 2008.
31.2	Rule 13a-14(a) Certification of Alan Schroering for the Form 10-Q for the quarter ended September 30, 2008.
32.1	Section 1350 Certification of Harry Kletter and Alan Schroering for the Form 10-Q for the quarter ended September 30, 2008.
