

INDUSTRIAL SERVICES OF AMERICA INC /FL  
Form 10-K  
March 31, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

**FORM 10-K**

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

For Fiscal Year Ended December 31, 2008

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No.: 0-20979

**INDUSTRIAL SERVICES OF AMERICA, INC.**

(Exact name of registrant as specified in its charter)

Florida  
(State or other jurisdiction of  
incorporation or organization)

59-0712746  
(I.R.S. Employer  
Identification No.)

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7100 Grade Lane  
P.O. Box 32428  
Louisville, Kentucky 40232  
(502) 368-1661

(Address, including zip code, and telephone number,  
including area code, of registrant's principal executive offices)

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

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

Common Stock, \$.005 par value  
(Title of class)

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

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

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

Yes X No \_\_\_

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

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

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Aggregate market value of the 1,998,737 shares of voting Common Stock held by non-affiliates of the registrant at the closing sales price on June 30, 2008: \$31,839,875.

Number of shares of Common Stock, \$.005 par value, outstanding as of the close of business on March 31, 2009: 3,575,292.

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DOCUMENT INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2009 Annual Meeting of Shareholders are incorporated by reference into Item 10 through Item 14 of Part III of this report.

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## PART I

### Item 1. Business.

#### General

Industrial Services of America, Inc. (herein "ISA," the "Company," "we," "us," "our," or other similar terms), is a Louisville, Kentucky-based logistic management services company that provides recycling and scrap processing and waste handling equipment sales and service, as well as offering total package waste and recycling management services to commercial, industrial and logistic customers nationwide.

#### Available Information

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

Our principal products and services are ferrous and non-ferrous scrap metals, management services, and waste equipment sales, rental and service. 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 our stockholders.

#### ISA Recycling Operating Division

Since October 2005, we have focused much of our attention on our recycling business segment. We sell processed ferrous and non-ferrous scrap material to end-users such as steel mini-mills, integrated steel makers and foundries and refineries. We purchase ferrous and non-ferrous scrap material primarily from industrial and commercial generators of steel, iron, aluminum, copper, stainless steel and other metals as well as from other scrap dealers who deliver these materials directly to our facilities. We process these materials by sorting, shearing, cutting and/or baling. We also continue to focus on initiating growth in our management services business segment and our waste and recycling equipment sales, service and leasing division.

#### Ferrous Operations

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

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

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

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

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

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*Ferrous Scrap Sales* - We sell processed ferrous scrap material to end-users such as steel mini-mills, integrated steel makers and foundries, and brokers who aggregate materials for other large users. Most customers purchase processed ferrous scrap material through negotiated spot sales contracts, which establish the quantity purchased for the month and the pricing. The price we charge for ferrous scrap materials depends upon market supply and demand, as well as quality and grade of the scrap material.

### **Non-Ferrous Operations**

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

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

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

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

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

*Non-Ferrous Scrap Sales* - We sell processed non-ferrous scrap material to end-users such as foundries, aluminum sheet and ingot manufacturers, copper refineries and smelters, and brass and bronze ingot manufacturers. Prices for the majority of non-ferrous scrap materials change based upon the daily publication of spot and futures prices on COMEX or the London Metals Exchange.

### **Management Services Operations - Computerized Waste Systems (CWS)**

Our management services operations are in the business of commercial, retail and industrial waste and recycling management services. CWS offers a "total package" concept to commercial, retail and industrial customers for their waste and recycling management needs. Combining waste reduction and diversion, and waste equipment technology, CWS creates waste and recycling programs tailored to each customer's needs.

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The services we offer include locating and contracting with a hauling company and recycler at a reasonable cost for each participating location. CWS does not own waste-transporting trucks or landfills. We do not operate or partner with any of the national hauling or recycling companies, and none of these companies own us. We are able to maintain a neutral position for the benefit of our customers. We have designed and developed proprietary computer software that provides our personnel with relevant information on each customer's locations, as well as pertinent information on service providers, disposal rates, costs of equipment, including installation and shipping, disposal rates and recycling prices. This software has allowed us to build a database for serving our customers that have locations nationwide as well as Canada and Mexico. This software enables us to generate detailed monthly customized billing reports, and price tracking to accommodate our customers' needs.

Our management services division provides our customers evaluation, management, monitoring, auditing and cost reduction of non-hazardous solid waste removal and recycling activities. CWS has developed a network of over 2,300 hauling, landfill, recycling and equipment manufacturing and maintenance service providers throughout the United States and Canada. Through this network, we are able to provide pricing estimates for current and potential customers. CWS customer service representatives have access to this information through the computer software designed and developed to enhance the value offered to our customers. Through this information retrieval system and database, customer service representatives can review the accuracy of recent billings for hauling, landfill and recycling rates.

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**Waste and Recycling Equipment Sales and Services Operations-WESSCO-Waste and Sales Service Company**

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

**"Total Package" Concept**

We record revenues and costs in the period of delivery. Our management services division has third party service providers providing same day service for all waste removal and recycling services for our customers. Our recycling division purchases ferrous and nonferrous materials, cardboard and paper on a daily basis. We record these purchases in the period received. We record revenue and cost in the period of delivery. The products or services have value to the customer on a standalone basis. These services make up the "total package" concept.

**Company Background**

ISA was incorporated in October 1953 in Florida under the name Alson Manufacturing, Inc. From the date of incorporation through January 5, 1975, Alson designed and manufactured various forms of electrical products. In 1979, the Board of Directors and the shareholders of Alson commenced liquidation of all the tangible assets of Alson. On October 27, 1983, Harry Kletter, our Chairman of the Board and Chief Executive Officer, acquired 419,500 shares of ISA Common Stock. The existing directors resigned and five new directors were elected.

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

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

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



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

On February 15, 2005 we added a location in Lexington, Kentucky. We were using this property as a transfer station for ferrous and nonferrous material. There were no processing operations at this facility. We discontinued operations at this location in the first quarter of 2007 and currently sublease the location to an unaffiliated party.

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

During 2007, we entered into an asset purchase agreement for \$1,300,000 funded primarily by a note payable to Industrial Logistic Services, LLC, the sole member of which is Brian Donaghy, our president and chief operating officer, whereby we pay \$20,000 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 also paid ILS \$100,000 cash as a portion of the purchase price at the time of execution of the asset purchase agreement.

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During 2008, we added a location near our Grade Lane site. We purchased the former Allied System truck terminal at 6709 Grade Lane. The 20,182 square foot facility sits on 4.4 acres of asphalted parking area. ISA Logistics and Waste Equipment Sales and Service Company (WESSCO) will occupy this property, relocating from the main Louisville location, creating room for the new shredder and related maintenance equipment. We plan to widen Grade Lane to three lanes along our property, allowing traffic to move more freely and safely. The road improvements will accommodate our growth from the \$10 million shredder project. The shredder will shred ferrous and non ferrous scrap for domestic and international consumers. We can also use the shredder for a disaster plan by handling materials prior to landfill disposal and recycling purposes. We intend for the shredder to become fully operational by the end of the second quarter of 2009.

In January, 2009, we expanded into the stainless steel and high-temperature alloys recycling business by purchasing inventories from Ventures Metals, LLC, agreeing to lease its processing equipment and facilities on Camp Ground Road in Louisville, Kentucky and in Mobile, Alabama, and hiring key executives to head up a new ISA Alloys division.

In March, 2009, we transformed the Camp Ground Road location into a full-service recycling material receiving facility.

## **Industry Background**

Our operations primarily involve the collection and processing of ferrous and non-ferrous scrap metals. We collect industrial scrap metal and obsolete scrap metal, process it into reusable forms and supply the recycled scrap metals to our customers. Since October 2005, we have focused much of our attention on our recycling business segment. We sell processed ferrous and non-ferrous scrap material to end-users such as steel mini-mills, integrated steel makers and foundries and refineries. We purchase ferrous and non-ferrous scrap material primarily from industrial and commercial generators of steel, iron, aluminum, copper, stainless steel and other metals as well as from other scrap dealers who deliver these materials directly to our facilities. We process these materials by sorting, shearing, cutting and/or baling.

We manage non-hazardous solid waste and recyclables for retail, commercial and industrial customers. As such, the multi-billion dollar solid waste collection and disposal business drives the industry. The size of this industry has increased for the past several years and should continue to increase as landfill space decreases. Although society and industry have developed an increased awareness of environmental issues and recycling has increased, waste production also continues to increase. Because of environmental concerns, new regulations and cost factors, it has become difficult to obtain the necessary permits to build any new landfills. Management believes that with the consolidation taking place in the waste industry, it will become increasingly difficult for a customer to receive a fair price. We are, therefore, in a position to represent the best interest of the customer; this fact can only enhance our business.

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

**Competition**

On a commercial/industrial waste management level, we have competition from a variety of sources. Much of it is from companies that concentrate their efforts on a regional level. We believe that with the proprietary database of regional and national pricing, we will maintain our edge on a national basis.

There has been increased competition from national hauling and recycling companies. The large national hauling and recycling companies often attempt to handle all locations for a "national chain" customer. This scenario poses a potential conflict of interest since these hauling companies and recyclers can attain greater profitability from increases in hauling and disposal revenues and fluctuations in recycling prices. In addition to having an interest in higher hauling and disposal rates, the national hauling companies do not have operations in every community. Additionally, we have encountered evidence

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of some reluctance from independent hauling and recycling companies to work with national hauling and recycling companies for locations not serviced by these national companies.

There is also competition from some equipment manufacturers. The primary interest of these companies is selling, leasing and renting equipment and offering management services in order to secure these sales or leases. There is a cost involved in using the equipment and the money saved must justify the amount spent on this equipment.

The metal recycling business is highly competitive and is subject to significant changes in economic and market conditions. Certain ISA competitors have greater financial, marketing and physical resources. There can be no assurance that we will be able to obtain our desired market share based on the competitive nature of this industry.

An important difference between us and the majority of our competition is our management process. Our systematic approach attempts to provide consistent results for the customer. At the implementation stage, we actively bid out every location that a new customer requests. We repeat this bidding process any time a customer receives notice of an undocumented price increase or at regular intervals as indicated in the contract. At subsequent stages, we will evaluate a customer's solid waste and recycling program and provide alternatives for improvement.

We have developed a network of maintenance, hauling, disposal, equipment and recycling companies throughout the country and in Canada, and due to the volume of business we have awarded to them, these companies will often offer us discounted hauling, disposal and maintenance rates and increased recycling prices. However, no company or service provider in the hauling, disposal, recycling, equipment and/or maintenance industries owns or controls us. We deal with those companies and service providers that can supply quality service and products at a favorable price and understand that as long as we serve our customers well, we and our service providers will have the opportunity to bid on future accounts.

Few, if any, of our competitors have a national network of service providers similar to the one we have developed over our years of operation. Although the major hauling and recycling companies have operating companies in most major and intermediate-sized cities, they do not have nationwide geographic coverage. Therefore, for large commercial and industrial clients, they must obtain bids from local hauling, disposal and recycling companies that may perceive them to be future competitors. We have positioned ourselves to negotiate with the haulers, landfill operators and recyclers while servicing our customers on a nationwide basis.

## **Employees**

As of December 31, 2008, ISA had one hundred twenty six (126) full-time employees as follows: recycling 62, management services 13, sales/leasing 5, drivers 15, maintenance 16, and administration/information technology 15. None of our employees is a member of a union.

## **Effect of State and Federal Environmental Regulations**

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

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

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

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

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

#### **Subsequent Events**

On January 13, 2009 we entered into an inventory purchase agreement with Venture Metals, LLC and its members, Steve Jones, Jeff Valentine and Carlos Corona, under which we agreed to pay to Venture Metals \$8,846,794 for inventory comprised of stainless steel and high temperature alloys, which we verified as to weight. We funded the purchase of the inventory through our line of credit with Branch Banking and Trust Company.

Under the agreement, we also have the right to retain the use of the property located at 3409 Camp Ground Road, Louisville, Kentucky, the site of the Venture Metals business that Venture Metals leases from Luca Investments, LLC, an affiliate of Venture Metals, owned 50% each by Messrs. Jones and Valentine. We have the right to use the facilities located on those premises for a period not to exceed two years from the date of the agreement for a monthly rental of \$15,000. Messrs. Jones, Valentine and Corona are our employees.

On February 11, 2009, we executed a promissory note, loan agreement and related security documents with Branch Banking and Trust Company in the amount of \$12,000,000 for the purpose of financing our acquisition of inventory and fixed assets from Venture Metals, and real estate at 3409 Camp Ground Road, Louisville, Kentucky, from Luca Investments, LLC, an affiliate of Venture Metals. The maturity date of this note is February 11, 2010. Interest is payable monthly commencing March 11, 2009, and the note shall bear interest at the adjusted LIBOR rate of one month LIBOR plus 2.25% per annum with a floor of 4%. All our assets (except rental fleet equipment) secure this note.

On February 18, 2009, and effective February 11, 2009, we entered into a lease agreement with Venture Metals, leasing from Venture Metals all of the fixed assets of Venture Metals, located at 3409 Camp Ground Road, Louisville, Kentucky. We have agreed to pay rent in the amount of \$15,000 per month commencing March 1, 2009, with a pro rata amount to be paid for the period from February 11, 2009 through February 28, 2009.

**ITEM 1A. Risk Factors**

**Risk Factors**

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

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

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*Risks Related to Our Operations*

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

Many companies offer or are engaged in the development of products or the provisions of services that may be or are competitive with our current products or services, although we do not believe any competition offers the unique mixture of the services and products we provide in the waste management area. Many entities have substantially greater financial, technical, manufacturing, marketing, distribution and other resources than we possess. In addition, the industry is constantly changing as a result of consolidation that may create additional competitive pressures in our business environment.

**Volatility in market prices of inventory may adversely affect our business.**

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

We believe that the long-term fundamentals supporting the prices for recycled metals remain positive; however, given the current trends in the market for ferrous and nonferrous metal, we believe that fiscal 2009 selling prices will be lower than those seen in 2008. Due to the high level of uncertainty regarding the economic environment, our past trends of sales volumes may not be indicative of expected volumes in fiscal 2009.

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

Our operations are dependent upon fuel, which we generally purchase in the open market on a daily basis. Direct fuel costs include the cost of fuel and other petroleum-based products used to operate our fleet of cranes and heavy equipment. We are also susceptible to increases in indirect fuel costs which include fuel surcharges from vendors. During 2006, 2007 and 2008, we experienced increases in the cost of fuel and other petroleum-based products, although these prices decreased somewhat in later 2008. A portion of these increases we passed on to our customers. However, because of the competitive nature of the industry, there can be no assurance that we will be able to pass on current or future increases in fuel prices to our customers. Due to political instability in oil-producing countries, fuel prices may continue to increase in 2009. A significant increase in fuel costs could adversely affect our business.

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



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

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

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

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

Our success is dependent on the management and leadership skills of our senior management team. We have not entered into employment agreements with any of our senior management personnel with the exception of our president and chief operating officer, Brian Donaghy, and our vice president of ISA Recycling, James Wiseman III. The loss of any members of our management team or the failure to attract and retain additional qualified personnel could prevent us from implementing our business strategy and continuing to grow our business at a rate necessary to maintain future profitability.

**Seasonal changes may adversely affect our business and operations.**

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

*Risks Related to Our Common Stock*

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

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

**The market price for our common stock may be volatile.**

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

- our quarterly operating results or the operating results of our companies in the waste management or ferrous, non-ferrous and fiber recycling industry;
  
- changes in general conditions in the economy, the financial markets or the ferrous, non-ferrous and fiber recycling industry;

- loss of significant customers and
  
- increases in materials and other costs.

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

**Item 2. Properties.**

**Related Parties Agreements -- K&R**

On February 16, 1998 our Board of Directors ratified and formalized an existing relationship in connection with (i) our leasing of facilities from K&R, LLC and (ii) the provision of consulting services from K&R to us. K&R is our affiliate because our Chief Executive Officer is our principal shareholder and he owns 100% of K&R.

Lease Agreement. This K&R lease, effective as of January 1, 1998, covers approximately 20.5 acres of land and the improvements thereon, which are located at 7100 Grade Lane in Louisville, Kentucky. The principal improvements consist of the following:

- an approximately 22,750 square foot building used as the corporate and CWS offices;
  - an approximately 8,286 square foot building used for sales/leasing and information technology offices;
  - an approximately 13,995 square foot building used as the paper recycling plant;
  - an approximately 12,000 square foot building used for the metals recycling plant;
-

- an approximately 51,760 square foot building used as the recycling offices and warehouse space;
- and the remaining 15,575 square feet of space contained in five (5) buildings ranging in size from approximately 256 to 8,000 square feet.

The initial term of the K&R lease was for ten years with two five-year option periods available thereafter. In 2007, we extended this lease agreement for five years per the terms of the lease. The base rent for the first five years was \$450,000 per annum. The rent for the second five years, beginning January 1, 2003, became \$505,272 per annum, payable at the beginning of each month in an amount equal to \$42,106. The rent for the third five years, beginning January 1, 2008, became \$582,000 per annum, payable at the beginning of each month in an amount equal to \$48,500. This fixed minimum rent adjusts each five years, including for each of the option periods, in accordance with the consumer price index. The fixed minimum rent also increases to \$750,000 per annum, in an amount equal to \$62,500 per month in the event of our change in control. We must pay, as additional rent, all real estate taxes, insurance, utilities, maintenance and repairs, replacements (including replacement of roofs if necessary) and other expenses. The K&R lease provides for our indemnification of K&R for all damages arising out of our use of or the condition of the leased premises excepting therefrom K&R's negligence.

In 2004, we paid for repairs totaling \$302,160 that we made to the buildings and property that we lease from K&R, located at 7100 Grade Lane, Louisville, Kentucky. K&R executed an unsecured promissory note, dated March 25, 2005 but effective December 31, 2004, to us for the principal sum of \$302,160. K&R makes payments on the promissory note of principal and interest in ninety-six (96) monthly installments of \$3,897.66. The rate of interest is five and one-half percent (5.5%) per annum. Failure of K&R to make any payment when due under this note within fifteen (15) days of its due date shall constitute a default. After the fifteen day period, the note shall bear interest at a rate equal to fifteen percent (15%) per annum and we have the right to exercise our remedies to collect full payment of the note.

In an addendum to the K&R lease as of January 1, 2005, the rent was increased \$4,000 as a result of the improvements made to the property in 2004. For years 2008 and 2007, the payments to K&R by the Company of \$4,000 for additional rent and the monthly payment from K&R to the Company of \$3,897.66 for the promissory note were offset.

*K&R Consulting Agreement.* The K&R consulting agreement remains in effect until December 31, 2009, with automatic annual renewals thereafter unless one party provides written notice to the other party of its intent not to renew at least six months in advance of the next renewal date. We have renewed this consulting agreement for one year. K&R shall provide strategic planning for mergers and acquisitions. We pay to K&R \$240,000 in equal monthly installments of \$20,000 in connection with the K&R consulting activities.

The K&R consulting agreement terminates upon a non-defaulting party providing written notice to the other party of its intent to terminate. The recipient of the notice has 10 days to cure monetary defaults and 30 days to cure non-monetary defaults. Upon termination, K&R agrees not to engage, directly or indirectly, in the business conducted by, or hire our employees for a period of five years and within 100 miles of any of our operations.

We compensate our principal shareholder and Chief Executive Officer through consulting fees paid pursuant to the K&R consulting agreement.

#### **Lease and Sublease Agreements -- Lexington**

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We have subleased the Lexington property to an unaffiliated party for a term that commenced March 1, 2007 and ends 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 sublessee defaults, we remain liable for the remainder of the lease payments through December 31, 2012.

### **Lease Agreement - Louisiana**

On February 6, 2007, we leased 7.7 acres of real property, including a 38,000 square foot warehouse and a 400 square foot office, in Pineville, Louisiana for \$5,250 per month for twenty-four months beginning March 1, 2007 and ending February 28, 2009, with an option to purchase the property for a purchase price of \$575,000. On January 18, 2008, we sold our position in this property, including the lease and the option, for \$25,000.

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### **Property Purchase - New Albany**

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

### **Property Lease -- Camp Ground Road, Louisville, Kentucky**

On January 13, 2009, we entered into an inventory purchase agreement with Venture Metals, LLC, one of the terms of which provided us with the right to retain the use of the property located at 3409 Camp Ground Road, Louisville, Kentucky, for a period not to exceed two years for a monthly rental of \$15,000. The property consists of 5.67 acres with a 7,875 square foot building to be used for our aluminum scrap business located thereon. We currently employ certain of the principal owners of Venture Metals.

### **Item 3. Legal Proceedings.**

In May 2006, All American Recycling, known as 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 R.D. Burton and Donna Burton v. Industrial Services of America, Inc., et. al., Jefferson Circuit Court, Case No. 06-C-04701), as further described in the Form 10-Q for the period ended September 30, 2008. On January 14, 2009, a Jefferson County, Kentucky Circuit Court jury awarded AAR approximately \$990,000 primarily for a breach of the agreement that required us to provide referrals to AAR. We reserved for the loss in an approximate amount of \$990,000 in our financial statements for the year ended December 31, 2008, and we paid the settlement amount of \$990,000 in February 2009. On February 2, 2009, the parties to the lawsuit entered into a settlement agreement that resulted in the dismissal of the case with prejudice on February 17, 2009 and provided for, among other items, the payment of the jury award on February 9, 2009, by the defendants to the plaintiffs. In addition, AAR agreed to vacate by March 31, 2009 the premises at Grade Lane, Louisville, Kentucky, that AAR subleased from us. AAR also agreed to be subject to a non-competition and non-solicitation term beginning February 2, 2009, for one year, wherein AAR has agreed not to engage in competition with, or solicit business or employees from, us during that period and within a distance of 2.5 miles of our Grade Lane facilities.

After AAR leaves the Grade Lane facilities, we intend to relocate the stainless steel inventory operations of Venture Metals from the Camp Ground Road location to the vacated premises on Grade Lane. We then intend to renovate the Camp Ground Road facilities to become a full-service yard for the purpose of providing ferrous, non-ferrous and stainless material for the Grade Lane operations.

On January 4, 2007, Lennox Industries, Inc., a commercial heating and air-conditioning manufacturer, filed suit against us in the Arkansas County, Arkansas Circuit Court in the case styled Lennox Industries, Inc. v. Industrial Services of America, Inc., Case No. CV-2007-004. Because of settlement negotiations, Lennox did not serve us until May 23, 2007. Lennox alleges that we breached a 2001 contract with Lennox where we agreed to act as agent for Lennox, by our failure to properly evaluate, categorize, classify and value the production scrap and waste of Lennox, thereby brokering such products at prices below market value. Lennox also alleges negligence and breach of fiduciary duty related to the same alleged failure. Lennox is taking the position that ISA had a duty to obtain a price that was consistent with the materials being sold on their behalf that it failed to show a proper duty of care in its dealings with Lennox. On July 9, 2008, Lennox amended its Complaint to add a cause of action based on fraud and misrepresentation (civil fraud). The Lennox complaint does not state any specific monetary damages. We have filed an answer denying all claims. The litigation is in its discovery phase with a trial date currently set for July 2009. We currently believe that the claims have no merit.

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

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

None.

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**Item 4a. ISA Executive Officers.**

| <u>Name</u>           | <u>Served as an Executive Officer From</u> | <u>Age</u> | <u>Position with the Registrant and Other Principal Occupations</u>   |
|-----------------------|--|------------|---|
| Harry Kletter         | 1983                                       | 82         | ISA Chairman of the Board and Chief Executive Officer from May 2, 2000 to 2007. ISA Chairman of the Board and Chief Visionary Officer from February 3, 2000 to May 2, 2000. Mr. Kletter served as Chairman of the Board and Chief Executive Officer from July 31, 1992 to February 3, 2000, President of ISA from July 31, 1992 to December 1997, from January 1990 to July 1991, and from October 1983 to January 1988. Mr. Kletter is also Chairman and sole shareholder of K&R, LLC. |
| Brian Donaghy         | August 2007                                | 33         | President and Chief Operating Officer since August 2007. Mr. Donaghy served as ISA's acting COO from January 1, 2007 through August 2007. Prior to his appointment to that position, Mr. Donaghy was a consultant to ISA Recycling. From 2001 to 2007, he owned and operated Industrial Logistic Services, LLC, a scrap metal and waste transportation company located at ISA's Louisville headquarters, the assets of which he has sold to ISA in 2007.                                |
| Alan L. Schroering    | 2000                                       | 44         | ISA Chief Financial Officer since May, 2001. Mr. Schroering served as an ISA board member from June 2000 to May 2001. Mr. Schroering has served as Treasurer from October 2001 to present. Mr. Schroering served in several accounting positions with National Processing Company from April 1998 to May 2000. Mr. Schroering served previously in several accounting positions with ISA from November 1984 to March 1998.  |
| James K. Wiseman, III | August 2007                                | 55         | Vice President of ISA Recycling since August 2007. Midwest Metals, Inc. in Louisville, Kentucky employed Mr. Wiseman from May 1997 to March 2007 as general manager of the physical scrap operation and trader of non-ferrous metals.   |

None of the above officers is related to any other. With respect to certain arrangements with certain officers of ISA relating to executive compensation, see section entitled "Executive Compensation - Certain Transactions" in ISA's Proxy Statement for the 2009 Annual Meeting of Shareholders as incorporated herein by reference at Item 11.



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

Effective August 29, 1996, the \$.01 par value ISA common stock became listed on the Small Cap Market (the "Small Cap Market") of the NASDAQ Stock Market under the symbol "IDSA." Prior to August 29, 1996, our common stock traded on the Over the Counter Bulletin Board operated by the National Association of Securities Dealers, Inc. High and low sales price of the common stock price is summarized as follows:

| <u>Quarter Ended</u> | <u>2008</u> |         | <u>2007</u> |         | <u>2006</u> |        |
|----------------------|-------------|---------|-------------|---------|-------------|--------|
|                      | High        | Low     | High        | Low     | High        | Low    |
| March 31             | \$ 11.27    | \$ 6.00 | \$ 7.22     | \$ 5.37 | \$ 5.20     | \$3.22 |
| June 30              | \$17.74     | \$ 8.82 | \$17.19     | \$ 6.84 | \$ 8.00     | \$4.82 |
| September 30         | \$19.50     | \$ 8.30 | \$14.51     | \$ 8.76 | \$ 6.31     | \$5.58 |
| December 31          | \$10.38     | \$ 4.37 | \$13.38     | \$ 7.36 | \$ 6.72     | \$5.26 |

There were approximately 356 shareholders of record as of December 31, 2008.

Until August 8, 2000, we had always had a policy intending that we would retain earnings to help finance our expansion programs. On August 8, 2000, our Board of Directors approved a change in the dividend policy whereby our Board of Directors could declare dividends. The Board of Directors, at its regular annual meeting June 26, 2008, declared a cash dividend payment of ten cents (\$0.10) per common share of stock for shareholders of record as of July 31, 2008, with a payment date of August 21, 2008. The Board of Directors, at our May 15, 2007 annual meeting, declared a cash dividend payment of ten cents (\$0.10) per common share for shareholders of record as of June 15, 2007 with a payment date of July 20, 2007.

Under our loan agreement with Branch Banking and Trust Company, our Board of Directors does not have the discretionary power to declare dividends or pay any dividends without the prior written consent of BB&T.

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. In 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. We repurchased 673,400 shares of our common stock in a prior stock repurchase program that began in August 2000.

**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 |
|--------|----------------------------------|------------------------------|--|--|
|--------|----------------------------------|------------------------------|--|--|

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|         |        |            |         |         |
|---------|--------|------------|---------|---------|
| 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 |
| May-08  | 9,854  | \$ 11.4170 | 85,116  | 114,884 |
| Sept-08 | 26,000 | \$ 9.7902  | 111,116 | 88,884  |

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**Item 6. Selected Financial Data.****Selected Financial Data**

|   | <u>2008</u>       | <u>2007</u>      | <u>2006</u>      | <u>2005</u>       | <u>2004</u>       |
|---|-------------------|------------------|------------------|-------------------|-------------------|
| (Amounts in Thousands, Except Per Share Data) |                   |                  |                  |                   |                   |
| Year ended December 31:                       |                   |                  |                  |                   |                   |
| Total revenue                                 | <u>\$ 100,042</u> | <u>\$ 76,956</u> | <u>\$ 62,082</u> | <u>\$ 117,382</u> | <u>\$ 139,588</u> |
| Net income (loss)                             | <u>1,528</u>      | <u>2,564</u>     | <u>2,188</u>     | <u>1,102</u>      | <u>1,497</u>      |
| Earnings (loss)                               |                   |                  |                  |                   |                   |
| per common share:                             |                   |                  |                  |                   |                   |
| Basic   | <u>\$ 0.43</u>    | <u>\$ 0.71</u>   | <u>\$ 0.61</u>   | <u>\$ 0.31</u>    | <u>\$ 0.43</u>    |
| Diluted                                       | <u>\$ 0.43</u>    | <u>\$ 0.71</u>   | <u>\$ 0.61</u>   | <u>\$ 0.31</u>    | <u>\$ 0.42</u>    |
| Cash dividends declared                       |                   |                  |                  |                   |                   |
| per common share                              | <u>\$ 0.10</u>    | <u>\$ 0.10</u>   | <u>\$ -</u>      | <u>\$ -</u>       | <u>\$ 0.10</u>    |
| At year end:                                  |                   |                  |                  |                   |                   |
| Total assets                                  | <u>\$ 28,791</u>  | <u>\$ 26,285</u> | <u>\$ 19,332</u> | <u>\$ 17,884</u>  | <u>\$ 21,079</u>  |
| Long-term debt and capital lease              |                   |                  |                  |                   |                   |
| obligations, net of current maturities        | <u>\$ 8,531</u>   | <u>\$ 8,495</u>  | <u>\$ 2,858</u>  | <u>\$ 153</u>     | <u>\$ 1,272</u>   |

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

*The following discussion and analysis should be read in conjunction with the information set forth under Item 6, "Selected Financial Data" and our consolidated financial statements and the accompanying notes thereto included elsewhere in this report.*

*The following discussion and analysis contains certain financial predictions, forecasts and projections which constitute "forward-looking statements" within the meaning of the federal securities laws. Actual results could differ materially from those financial predictions, forecasts and projections and there can be no assurance that we will achieve such financial predictions, forecasts and projections. Please see Item 1A, "Risk Factors" for items that could affect our financial predictions, forecasts and projections.*

**General**

We are 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 approximately 2,100 customer locations throughout the United States and we utilize an active database of over 6,500 vendors to provide timely, thorough and cost-effective service to our customers.

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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, and Seymour and New Albany, Indiana. We closed the Lexington, Kentucky location in the first quarter of 2007 and our location in Pineville, Louisiana in January 2008. We do not have operating locations outside the United States.

### **Liquidity and Capital Resources**

As of December 31, 2008, we held cash and cash equivalents of \$1,103,842.

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 January 1, 2012, 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, and is secured by all our assets (except rental fleet equipment). The revolving credit facility contains certain restrictive and financial covenants. At December 31, 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 February 11, 2009, we executed a promissory note, loan agreement and related security documents with Branch Banking and Trust Company in the amount of \$12,000,000 for the purpose of financing our acquisition of inventory and fixed assets from Venture Metals, and real estate at 3409 Camp Ground Road, Louisville, Kentucky, from Luca Investments, LLC, an affiliate of Venture Metals. The maturity date of this note is February 11, 2010. Interest is payable monthly commencing March 11, 2009, and the note shall bear interest at the adjusted LIBOR rate of one month LIBOR plus 2.25% per annum with a floor of 4%. As of February 11, 2009, the applicable interest rate was 4% since the calculated rate was 2.67%. All our assets (except rental fleet equipment) secure this note. As a result of this note and related loan documents, we and BB&T undertook amendments to existing security agreements related to a \$10,000,000 borrowing line from BB&T, dated December 22, 2006, a BB&T Bankcard Corporation Commercial Card Application and BB&T Bankcard Corporation Commercial Card Plan Agreement, executed December 9, 2003 and December 8, 2003, and a \$6,000,000 equipment loan to purchase our shredder system and complimentary facility improvements, dated May 7, 2008, so as to provide that the security for each of the above loans also secures the \$12,000,000 loan of February 11, 2009.

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 also paid ILS \$100,000 cash as a portion of the purchase price at the time of execution of the asset purchase agreement. We recorded a note payable of \$1,010,040 with an outstanding balance at December 31, 2008 of \$774,161.

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

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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. The terms of the loan agreement place certain restrictive covenants

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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 December 31, 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 complementary 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 complementary 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 continued 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. 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 December 31, 2008, we were in compliance with all restrictive covenants.

During 2008, we paid \$3,571,740 for land, improvements, property and equipment. We paid \$1,190,000 for the land and building at 6709 Grade Lane. We paid \$178,022 for other buildings and improvements. In the recycling segment we paid \$1,104,150 for cranes, a forklift, balers, shear rebuild, scales, trailers, grapple and other operating equipment. In the equipment sales, leasing and service segment, we purchased \$488,993 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 \$129,682 of office equipment and \$480,893 in vehicles.

In January, 2009, we expanded into the stainless steel and high-temperature alloys recycling business by purchasing inventories from Ventures Metals, LLC, agreeing to lease its processing equipment and facilities on Camp Ground Road in Louisville, Kentucky and in Mobile, Alabama, and hiring key executives to head up a new ISA Alloys division.

On February 18, 2009, and effective February 11, 2009, we entered into a lease agreement with Venture Metals, leasing from Venture Metals all of the fixed assets of Venture Metals, located at 3409 Camp Ground Road, Louisville, Kentucky. Refer to Subsequent Events, page 8, for more information.

In March, 2009, we transformed the Camp Ground Road location into a full-service recycling material receiving facility.

We implemented the use of a purchasing card with a credit limit of \$6.0 million in the second quarter of 2004. We have included the balance due on the purchasing card as part of accounts payable. The outstanding balance on the purchasing card at December 31, 2008 was \$736,157 with a due date of January 25, 2009, which we paid in full before the due date. The card accrues interest at prime plus 5.9% after the first

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twenty-five days of the purchase; however, 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, including the purchasing card, will be sufficient to meet our cash needs in 2009.

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### **Critical Accounting Policies**

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

### **Revenue recognition**

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

### **Accounts receivable and allowance for doubtful accounts receivable**

Accounts receivable consist primarily of amounts due from customers from product and brokered sales. The allowance for doubtful accounts receivable totaled \$490,000 at December 31, 2008 and \$100,000 at December 31, 2007. Our determination of the allowance for doubtful accounts receivable includes a number of factors, including the age of the balance, past experience with the customer account, changes in collection patterns and general industry conditions and overall economic conditions impacting industry and customers.

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

### **Inventory**

Our inventories primarily consist of ferrous and non-ferrous scrap metals and we value at the lower of average purchased cost or market. We determine quantities of inventories based on our inventory systems, which are subject to periodic physical verification using estimation techniques including observation, weighing and other industry methods. Prices of commodities we own may be volatile. We are exposed to risks associated with fluctuations in the market price for both ferrous and non-ferrous metals, which are at times volatile. We attempt to mitigate this risk by seeking to rapidly turn our inventories.

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

We believe that the long-term fundamentals supporting the prices for recycled metals remain positive; however, given the current trends in the market for ferrous and nonferrous metal, we believe that fiscal 2009 selling prices will be lower than those seen in 2008. Due to the high level of uncertainty regarding the economic environment, our past trends of sales volumes may not be indicative of expected volumes in fiscal 2009.

### **Property and Equipment**

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

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**Valuation of long-lived assets and goodwill**

We regularly review the carrying value of certain long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be realizable. If an evaluation is required, we compare the estimated future undiscounted cash flows associated with the asset to the asset's carrying amount to determine if an impairment of such asset is necessary. The effect of any impairment would be to expense the difference between the fair value of such asset and its carrying value. During the year ended December 31, 2008, we determined no impairment existed.

We review goodwill at least annually for impairment based on the fair value method prescribed in Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill." At December 31, 2008, we determined, based on current industry and other market information, that no impairment existed.

**Derivative Instruments**

Beginning in October, 2008, we have utilized derivative instruments in the form of interest rate swaps to assist in managing our interest rate risk. We do not enter into any interest rate swap derivative instruments for trading purposes. We account for the interest rate swaps in accordance with Statement of Financial Accounting Standard ("SFAS") No. 133 "Accounting for Derivative Instruments and Hedging Activities," as amended.

**Income Taxes**

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

**Results of Operations**

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

| <u>Year ended December 31,</u>                 | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--|-------------|-------------|-------------|
| <b>Consolidated Statements of Income Data:</b> |             |             |             |
| Total revenue .....                            | 100.0%      | 100.0%      | 100.0%      |
| Total cost of goods sold.....                  | 86.3%       | 84.5%       | 85.4%       |

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|  |       |       |      |
|--|-------|-------|------|
| Selling, general and administrative expenses ..... | 10.2% | 10.1% | 9.0% |
| Income before other income (expense).....          | 3.5%  | 5.4%  | 5.6% |

**Accumulated Other Comprehensive Income (Loss)**

Comprehensive income is net income plus certain other items that are recorded directly to shareholders' equity. Amounts included in other accumulated comprehensive loss for our derivative instruments are recorded net of the related income tax effects. Refer to Note 1 for additional information about our derivative instruments. The following table gives further detail regarding the composition of other accumulated comprehensive income (loss) at December 31, 2008 and 2007.

|   | <b>12/31/2008</b> | <b>12/31/2007</b> |
|---|-------------------|-------------------|
| Net unrealized losses on derivative instruments, net of tax | <u>\$ 475,342</u> | <u>\$ -</u>       |
| Total accumulated other comprehensive income (loss)         | <u>\$ 475,342</u> | <u>\$ -</u>       |

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**Year Ended December 31, 2008 Compared to Year Ended December 31, 2007**

Total revenue increased \$23,086,950 or 30.0% to \$100,042,491 in 2008 compared to \$76,955,541 in 2007. Recycling revenue increased \$21,942,491 or 38.1% to \$79,545,562 in 2008 compared to \$57,603,071 in 2007. This change is due to an increase of 2% in the volume of shipments and an increase of 32% in average price per ton over the course of 2008. However, in the fourth quarter 2008, demand and prices decreased due to reduced demand for scrap and recycled metal arising from weaker economic conditions, which led to a reduction in ferrous sales volumes and average nonferrous selling prices. In addition, continued weak demand and the impact of declines in anticipated future selling prices which outpaced the decline in inventory costs, results in ISA recording a non-cash net realizable value ("NRV") inventory write-down of \$1.2 million. Management services revenue increased \$948,532 or 5.5% to \$18,182,726 in 2008 compared to \$17,234,194 in 2007. This change is primarily due to new customers in the first three quarters of 2008, slightly offset by the loss of two large customers in late 2008. Equipment, service and leasing revenue increased \$195,927 or 9.2% to \$2,314,203 in 2008 compared to \$2,118,276 in 2007. This increase is primarily due to growth in equipment rental revenue due to new customers.

Total cost of goods sold increased \$21,355,242 or 32.8% to \$86,370,152 in 2008 compared to \$65,014,911 in 2007. Recycling cost of goods sold increased \$18,620,700 or 36.9% to \$69,027,772 in 2008 compared to \$50,407,072 in 2007 due to an increase in the volume of shipments as well as an increase in the volume of purchases of 8% and an increase in average cost per ton of 10%. Management services cost of goods sold increased \$2,126,913 or 14.8% to \$16,502,452 in 2008 compared to \$14,375,539 in 2007. This change is primarily due to new customers in the first three quarters of 2008, slightly offset by the loss of two large customers in late 2008. We also reduced CWS cost of goods sold by \$858,249 in 2007 due to a change in management's estimate related to the liability associated with this operation. Equipment, service and leasing cost of goods sold increased \$607,628 to \$839,928 in 2008 compared to \$232,300 in 2007. This increase is primarily due to the increases in equipment costs, such as containers and compactors, purchased for resale and reclassification of cost of sales expenses.

We make certain assumptions regarding future demand and net realizable value in order to assess that inventory is properly recorded at the lower of cost or market. We base our assumptions on historical experience, current market conditions and current replacement costs. Due to declines in the anticipated future selling prices of scrap metal and finished steel products, we recorded non-cash net realizable value inventory adjustments of \$1.2 million in the fourth quarter of 2008 to reduce the value of our inventory (and increase cost of goods sold) to the lower of cost or market.

Selling, general and administrative expenses increased \$2,448,990 or 31.5% to \$10,215,904 in 2008 compared to \$7,766,915 in 2007. The increase in SG&A is primarily due to an increase of \$1,702,435 in costs associated with the ILS operation, including fuel, truck labor and overtime, depreciation, repairs and maintenance on vehicles and equipment, license and fees and other labor, and an increase of \$394,557 in bad debt expense. As a percentage of total revenue, selling, general and administrative expenses were 10.2% in 2008 compared to 10.1% in 2007.

Interest expense increased \$81,755 or 28.1% to \$372,444 in 2008 compared to \$290,689 in 2007 due to an increase in long term debt in 2008 compared to 2007.

Other income was \$336,802 in 2008 compared to other income of \$22,741 in 2007, an increase of \$314,061.

On January 14, 2009, a Jefferson County, Kentucky Circuit Court jury awarded AAR approximately \$990,000 primarily for a breach of the agreement that required us to provide referrals to AAR. We reserved for the loss in an approximate amount of \$990,000 in the other expense section of our financial statements for the year ended December 31, 2008 since the referrals were primarily related to prior years, and we paid the settlement amount of \$990,000 in February 2009.

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Significant components of other income (expense) are as follows:

| Description Other Income (Expense)            | Fiscal Year Ended December 31 |           |
|---|-------------------------------|-----------|
|   | 2008                          | 2007      |
| Change in accrual for note payable            | 156,400                       |           |
| Insurance claim                               | 117,306                       |           |
| Change in accrual for accounts payable        | 31,441                        |           |
| Flexible spending forfeitures                 | 13,741                        |           |
| Reversal of tax accrual for rental containers |                               | \$ 20,670 |
| Other   | 17,914                        | 2,071     |
| Total other income, net                       | \$ 336,802                    | \$ 22,741 |

The income tax provision is 40.1% for the year ended December 31, 2008 compared to 36.2% for the year ended December 31, 2007. The percentage increase is due primarily to the impact of a tax credit in 2007 of \$99,358 which lowered the 2007 provision by 2.5%.

### Financial Condition at December 31, 2008 compared to December 31, 2007

Cash and cash equivalents decreased \$397,843 to \$1,103,842 as of December 31, 2008 compared to \$1,501,685 at December 31, 2007.

Net cash from operating activities increased \$7,140,054 to \$7,776,353 as of December 31, 2008 compared to \$636,299 as of December 31, 2007. This increase was primarily due to decreases in accounts receivable and inventory of \$2,953,367 and \$255,933, respectively, and the increase in current liabilities such as income tax payable of \$566,025 and the accrual for legal settlements of \$1,037,165.

We used net cash from investing activities of \$7,783,824 for the year ending December 31, 2008 compared to \$4,251,092 for the same period in 2007. The difference of \$3,532,732 was primarily due to an increase of \$1,401,911 in purchases of property and equipment and \$4,374,826 spent on the shredder system in 2008 compared to \$2,173,076 spent in 2007.

Net cash from financing activities decreased \$4,175,043 to (\$390,372) for the year ending December 31, 2008 compared to \$3,784,671 for the same period in 2007. Proceeds from long term debt totaled \$8,773,555 in 2008 and \$7,850,000 in 2007, and payments on long-term debt were \$8,138,375 in 2008 and \$3,010,306 in 2007.

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 also paid ILS \$100,000 cash as a portion of the purchase price at the time of execution of the asset purchase agreement. We recorded a note payable of \$1,010,040 with an outstanding balance at December 31, 2008 of \$774,161.

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. 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 December 31, 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 complementary 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 complementary facility improvements on June 21, 2007. The note has a term beginning May 2008 and

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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 continued 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. 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 December 31, 2008, we were in compliance with all restrictive covenants.

We implemented the use of a purchasing card with a credit limit of \$6.0 million in the second quarter of 2004. We include the balance due on the purchasing card as part of accounts payable. The outstanding balance on the purchasing card at December 31, 2008 was \$736,157.

We believe our principal sources of liquidity from available funds on hand, cash generated from operations and the availability of borrowing under our senior revolving credit facility and purchasing card will be sufficient to fund operations in fiscal year 2009. Our primary sources of funds are our ability to generate cash from operations and the availability of borrowing under our senior revolving credit facility to meet our liquidity obligations, which could be affected by factors such as a decline in demand for our products, loss of key contract customers such as occurred with Circuit City and Mervyn's in 2008, our ability to generate profits and other unforeseen circumstances. The availability of our revolving credit facility is contingent on complying with certain debt covenants. We do not expect the covenants to limit or restrict our ability to borrow on the facility in fiscal year 2009.

Trade accounts receivable after allowances for doubtful accounts decreased \$2,953,367 or 43.6% to \$3,811,484 as of December 31, 2008. The primary reason for the decrease in trade accounts receivable after allowances for doubtful accounts is primarily a fourth quarter decrease in both the volume of shipments and the selling prices in the recycling segment.

Recycling accounts receivable decreased \$2,729,269 or 57% to \$2,084,702 as of December 31, 2008 compared to \$4,813,971 as of December 31, 2007. This change is primarily due to a decrease in the volume of shipments and selling prices in the recycling segment in the fourth quarter. On average, volume of ferrous shipments in gross tons decreased 36% in the fourth quarter of 2008 compared to the same period in 2007. On average, ferrous sales prices decreased 11% in the fourth quarter of 2008 compared to the same period in 2007. On average, volume of nonferrous shipments in pounds decreased 59% in the fourth quarter of 2008 compared to the fourth quarter of 2007. On average, nonferrous sales prices decreased 50% in the fourth quarter of 2008 compared to the same period in 2007.

CWS accounts receivable decreased \$198,258 or 10% to \$1,669,842 as of December 31, 2008 compared to \$1,868,100 as of December 31, 2007. Two of CWS's customers declared bankruptcy in 2008, and we increased our allowance for doubtful accounts by \$390,000 as a result of these bankruptcies.

WESSCO accounts receivable decreased \$25,366 or 36% to \$44,594 as of December 31, 2008 compared to \$69,960 as of December 31, 2007.



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 decreased \$255,933 or 5.5% to \$4,371,348 as of December 31, 2008 compared to \$4,627,281 as of December 31, 2007. Inventories as of December 31, 2008 and December 31, 2007 consist of the following:

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|                           | <b>December 31,<br/><u>2008</u></b> | <b>December 31,<br/><u>2007</u></b> |
|---------------------------|-------------------------------------|-------------------------------------|
| Ferrous                   | \$ 2,162,149                        | \$ 1,848,445                        |
| Non-Ferrous               | 2,033,154                           | 2,715,703                           |
| Waste equipment machinery | 95,675                              | 36,498                              |
| Other                     | <u>80,370</u>                       | <u>26,635</u>                       |
| Total inventories         | <u>\$ 4,371,348</u>                 | <u>\$ 4,627,281</u>                 |

For the year ended December 31, 2008, we shipped 81,050 gross tons of ferrous material. During the same period, we purchased 84,257 gross tons of ferrous material. For the year ended December 31, 2007, we shipped 81,947 gross tons of ferrous material. During the same period, we purchased 76,659 gross tons of ferrous material. As of December 31, 2008, ferrous inventory consisted of 11,374 gross tons at a unit cost of \$190.096 per gross ton. As of December 31, 2007, ferrous inventory consisted of 7,713 gross tons at a unit cost of \$239.65 per gross ton. For the year ended December 31, 2008, the purchase price plus processing costs of ferrous material averaged \$190.10 per gross ton compared to \$239.65 per gross ton in 2007.

For the year ended December 31, 2008, we shipped 34,342,392 pounds of nonferrous material. During the same period, we purchased 35,601,248 pounds of nonferrous material. For the year ended December 31, 2007, we shipped 28,840,349 pounds of nonferrous material. During the same period, we purchased 24,314,589 pounds of nonferrous material. As of December 31, 2008, nonferrous inventory consisted of 3,720,330 pounds with a unit cost of \$0.5465 per pound. As of December 31, 2007, nonferrous inventory consisted of 1,992,954 pounds at a unit cost of \$1.3626 per pound. For the year ended December 31, 2008, the purchase price plus processing costs of non-ferrous material has averaged \$0.546 per pound compared to \$1.363 per pound in 2007.

We make certain assumptions regarding future demand and net realizable value in order to assess that inventory is properly recorded at the lower of cost or market. We base our assumptions on historical experience, current market conditions and current replacement costs. Due to declines in the anticipated future selling prices of scrap metal and finished steel products, we recorded non-cash net realizable value ("NRV") inventory adjustments of \$1.2 million in the fourth quarter 2008 to reduce the value of our inventory (and increase cost of goods sold) to the lower of cost or market.

| <b>Year</b> | <b>Inventory Type</b> | <b>Gross Tons</b> | <b>Unit Cost</b> | <b>Amount</b> |
|-------------|-----------------------|-------------------|------------------|---------------|
| 2008        | Ferrous               | 11,374            | \$ 190.096       | \$ 2,162,149  |
| 2007        | Ferrous               | 7,713             | \$ 239.653       | \$ 1,848,445  |

| <b>Year</b> | <b>Inventory Type</b> | <b>Pounds</b> | <b>Unit Cost</b> | <b>Amount</b> |
|-------------|-----------------------|---------------|------------------|---------------|
| 2008        | Nonferrous            | 3,720,330     | 0.546%           | \$ 2,033,154  |
| 2007        | Nonferrous            | 1,992,954     | %1.363           | \$ 2,715,703  |

**Inventory Aging for the year ended December 31, 2008 (Days Outstanding)**

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| Description           | 1-30        | 31-60     | 61-90      | Over 90   | Total       |
|-----------------------|-------------|-----------|------------|-----------|-------------|
| Equipment & parts     | \$ 95,675   | \$ -      | \$ -       | \$ -      | \$ 95,675   |
| Ferrous Materials     | 1,364,091   | 376,684   | 326,874    | 94,500    | 2,162,149   |
| Non-ferrous materials | 990,843     | 217,591   | 294,992    | 529,728   | 2,033,154   |
| Other                 | 80,370      | -         | -          | -         | 80,370      |
|                       | \$2,530,979 | \$594,275 | \$ 621,866 | \$624,228 | \$4,371,348 |

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

| Description           | 1-30        | 31-60       | 61-90      | Over 90   | Total       |
|-----------------------|-------------|-------------|------------|-----------|-------------|
| Equipment & parts     | \$ 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 decreased \$963,736 or 20.7% to \$3,701,895 as of December 31, 2008 compared to \$4,665,631 as of December 31, 2007. Recycling accounts payable decreased \$665,015 or 50% to \$667,272 as of December 31, 2008 compared to \$1,332,287 as of December 31, 2007. This decrease is primarily due to the decrease in volume of commodity purchases at respective year-ends and decreased commodity purchase prices of ferrous and nonferrous materials. Our accounts payable payment policy in the recycling segment is consistent between years.

CWS accounts payable decreased \$145,802 or 4.7% to \$2,918,030 as of December 31, 2008 compared to \$3,063,832 as of December 31, 2007. This change is due to timing of payments.

WESSCO accounts payable increased \$12,830 or 15.2% to \$97,214 as of December 31, 2008 compared to \$84,384 as of December 31, 2007.

Working capital decreased \$4,951,168 to \$2,988,872 as of December 31, 2008 compared to \$7,940,040 as of December 31, 2007. Net income of \$1,527,598, depreciation of \$2,122,167 and the decrease in receivables of \$2,953,367 were positive contributors to working capital in 2008, offset by an increase in the liability from interest rate swap agreements of \$475,342. During 2008, we used these positive working capital contributors to purchase property and equipment of \$3,571,740.

**Contractual Obligations**

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The following table provides information with respect to our known contractual obligations for the year ended December 31, 2008.

| Obligation Description          | Payments due by period |                  |             |             |                   |
|---------------------------------|------------------------|------------------|-------------|-------------|-------------------|
|                                 | Total                  | Less than 1 year | 1-3 years   | 3-5 years   | More than 5 years |
| Long-term debt obligations      | \$9,367,877            | \$857,863        | \$2,138,067 | \$3,782,940 | \$ 2,589,007      |
| Capital lease obligations (1)   | 101,569                | 80,771           | 20,798      | 0           | 0                 |
| Operating lease obligations (2) | 2,596,561              | 684,882          | 1,275,679   | 636,000     | 0                 |
| Total                           | \$12,066,007           | \$1,623,516      | \$3,434,544 | \$4,418,940 | \$2,589,007       |

(1) 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.

(2) We lease the Louisville, Kentucky facility from a related party under an operating lease expiring December 2012 with automatic annual renewals thereafter unless one party provides written notice to the other party of its intent not to renew at least six months in advance of the next renewal date. We have monthly rental payments of \$48,500 through December 2012. In the event of a change of control, the monthly payments become \$62,500. See Item 1. Business -- Related Parties Agreements.

We also lease a management services operations facility and various pieces of equipment in Dallas, Texas for which monthly payments of \$2,750 are due through September 2009.

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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, which terminates December 31, 2012. If for any reason the sublessee defaults, we remain liable for the remainder of the lease payments through December 31, 2012.

On February 6, 2007, we leased 7.7 acres of real property, including a 38,000 square foot warehouse and a 400 square foot office, in Pineville, Louisiana for \$5,250 per month for twenty-four months beginning March 1, 2007 and ending February 28, 2009, with an option to purchase the property for a purchase price of \$575,000. On January 18, 2008, we sold our position in this property, including the lease and the option, for \$25,000.

### **Year Ended December 31, 2007 Compared to Year Ended December 31, 2006**

Total revenue increased \$14,873,493 or 24.0% to \$76,955,541 in 2007 compared to \$62,082,048 in 2006. Recycling revenue increased \$12,636,048 or 28.1% to \$57,603,071 in 2007 compared to \$44,967,023 in 2006. This change is due to an increase of 8% in the volume of shipments and an increase of 18% in average price per ton. Management services revenue increased \$1,846,953 or 12.0% to \$17,234,194 in 2007 compared to \$15,387,241 in 2006. This change is primarily due to new customers. Equipment, service and leasing revenue increased \$390,492 or 22.60% to \$2,118,276 in 2007 compared to \$1,727,784 in 2006. This increase is primarily due to growth in equipment rental revenue due to new customers.

Total cost of goods sold increased \$12,018,470 or 22.6% to \$65,014,911 in 2007 compared to \$52,996,441 in 2006. Recycling cost of goods sold increased \$10,958,115 or 27.8% to \$50,407,072 in 2007 compared to \$39,448,957 in 2006 due to an increase in the volume of shipments as well as an increase in the volume of purchases of 4% and an increase in average cost per ton of 18.3%. Management services cost of goods sold increased \$1,663,466 or 13.0% to \$14,375,539 in 2007 compared to \$12,712,073 in 2006. This change is primarily due to new customers. We also reduced CWS cost of goods sold by \$858,249 in 2007 and \$1,272,241 in 2006 due to a change in management's estimate related to the liability associated with this operation. Equipment, service and leasing cost of goods sold decreased \$603,111 or 72.2% to \$232,300 in 2007 compared to \$835,411 in 2006. This decrease is primarily due to the decreases in equipment costs, such as containers and compactors, purchased for resale and a decrease in service and repair expense.

Selling, general and administrative expenses increased \$2,156,956 or 38.4% to \$7,766,915 in 2007 compared to \$5,609,959 in 2006. The increase in SG&A is primarily due to costs associated with the ILS asset purchase, including stock bonus and increase in truck driver labor and overtime, an increase in fuel costs, and an increase in legal costs due to the settlement of a lawsuit. As a percentage of total revenue, selling, general and administrative expenses were 10.1% in 2007 compared to 9.0% in 2006.

Interest expense increased \$77,967 or 36.7% to \$290,689 in 2007 compared to \$212,722 in 2006 due to an increase in long term debt in 2007 compared to 2006. Other income was \$22,741 in 2007 compared to other income of \$32,930 in 2006, a decrease of \$10,189.

Significant components of other income (expense) are as follows:

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| Description                                   | Fiscal Year Ended December 31 |           |
|---|-------------------------------|-----------|
|   | 2007                          | 2006      |
| Reversal of tax accrual for rental containers | \$ 20,670                     |           |
| Bankruptcy recoveries                         | -                             | 22,787    |
| Interest on K&R note                          | -                             | 6,845     |
| Other   | 2,071                         | 3,298     |
| Total other income, net                       | \$ 22,741                     | \$ 32,930 |

The income tax provision is 36.2% for the year ended December 31, 2007 compared to 37.7% for the year ended December 31, 2006. The impact of the tax credit of \$99,358 was to lower the provision by 2.5%.

**Financial Condition at December 31, 2007 compared to December 31, 2006**

Cash and cash equivalents increased \$169,878 to \$1,501,685 as of December 31, 2007 compared to \$1,331,807 as of December 31, 2006.

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Net cash from operating activities increased \$1,853,222 to \$636,299 as of December 31, 2007 compared to net cash used of (\$1,216,923) as of December 31, 2006. This increase was primarily due to net income of \$2,563,833 and noncash stock transactions of \$426,364 offset by increases in accounts receivable and inventory of \$1,738,410 and \$1,199,055, respectively.

We used net cash from investing activities of \$4,251,092 for the year ending December 31, 2007 compared to \$2,058,807 for the same period in 2006. The difference of \$2,192,285 was primarily due to the \$2,173,076 deposit for the shredder system.

Net cash from financing activities increased \$898,435 to \$3,784,671 for the year ending December 31, 2007 compared to \$2,886,236 for the same period in 2006. Proceeds from long term debt totaled \$7,850,000 in 2007 and \$10,710,875 in 2006, and payments on long-term debt were \$3,010,306 in 2007 and \$7,770,984 in 2006.

On December 22, 2006, we executed a new revolving credit facility with BB&T increasing the borrowing line from \$5.0 million to \$10.0 million to provide us with working capital to support the current needs of our business. This revolving credit facility has a three year term expiring December 22, 2009, and provides for advances of up to eighty percent (80%) of ISA's eligible accounts receivable and up to the forty percent (40%) of eligible inventory, and up to one hundred percent (100%) of ISA's 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, and is secured by all our assets (except rental fleet equipment). As of December 31, 2007 we had borrowed \$6,000,000 and as of December 31, 2006 we had borrowed \$1,010,875 against the credit facility. The revolving credit facility contains certain restrictive and financial covenants. At December 31, 2007, we were in compliance with all restrictive covenants.

We also have a \$2.0 million loan with Fifth Third Bank secured by our rental fleet equipment. Indebtedness under this loan agreement accrues interest at a fixed interest rate of 6.83%. The maturity date under this agreement is June 2011 with a ten-year amortization schedule. As of December 31, 2007 we had borrowed \$1,779,585 and as of December 31, 2006 we had borrowed \$1,929,016 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 December 31, 2007, we were in compliance with all restrictive covenants.

We implemented the use of a purchasing card with a credit limit of \$6.0 million in the second quarter of 2004. We include the balance due on the purchasing card as part of accounts payable. The outstanding balance on the purchasing card at December 31, 2007 was \$885,537.

We believe our principal sources of liquidity from available funds on hand, cash generated from operations and the availability of borrowing under our senior revolving credit facility and purchasing card will be sufficient to fund operations in fiscal year 2008. Our primary sources of funds are our ability to generate cash from operations and the availability of borrowing under our senior revolving credit facility to meet our liquidity obligations, which could be affected by factors such as a decline in demand for our products, loss of key contract customers such as occurred with Home Depot in 2005, our ability to generate profits and other unforeseen circumstances. The availability of our revolving credit facility is contingent on complying with certain debt covenants. We do not expect the covenants to limit or restrict our ability to borrow on the facility in fiscal year 2008.

Trade accounts receivable after allowances for doubtful accounts increased \$1,738,410 or 34% to \$6,764,851 as of December 31, 2007. The primary reason for the increase in trade accounts receivable after allowances for doubtful accounts is an increase in the volume of shipments and



an increase in the selling prices in the recycling segment.

Recycling accounts receivable increased \$910,290 or 23% to \$4,813,971 as of December 31, 2007 compared to \$3,903,681 as of December 31, 2006. This change is primarily due to an increase in the volume of shipments and an increase in the selling prices in the recycling segment. On average, volume of ferrous shipments in gross tons increased 7% as of December 31, 2007 compared to December 31, 2006. On average, sales prices increased \$12 per gross ton or 4% to \$256 as of December 31, 2007 compared to \$244 as of December 31, 2006. On average, volume of nonferrous shipments in pounds increased 29% as of December 31, 2007 compared to December 31, 2006. On average, sales prices increased 9.7% as of December 31, 2007 compared to December 31, 2006.

CWS accounts receivable increased \$779,020 or 71% to \$1,868,100 as of December 31, 2007 compared to \$1,089,080 as of December 31, 2006. This change is primarily due to new customers.

WESSCO accounts receivable increased \$69,960 or 100% to \$69,960 as of December 31, 2007 compared to \$0 as of December 31, 2006. This change is primarily due to increased rental revenues from new customers.

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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 \$1,199,055 or 34% to \$4,627,281 as of December 31, 2007 compared to \$3,428,226 as of December 31, 2006. Inventories as of December 31, 2007 and December 31, 2006 consist of the following:

|                           | <b>December 31,<br/><u>2007</u></b> | <b>December 31,<br/><u>2006</u></b> |
|---------------------------|-------------------------------------|-------------------------------------|
| Ferrous                   | \$ 1,848,445                        | \$ 1,667,937                        |
| Non-Ferrous               | 2,715,703                           | 1,678,655                           |
| Waste equipment machinery | 36,498                              | 56,200                              |
| Other                     | <u>26,635</u>                       | <u>25,434</u>                       |
| <br>Total inventories     | <br><u>\$ 4,627,281</u>             | <br><u>\$ 3,428,226</u>             |

For the year ended December 31, 2007, we shipped 81,947 gross tons of ferrous material. During the same period, we purchased 76,659 gross tons of ferrous material. For the year ended December 31, 2006, we shipped 76,331 gross tons of ferrous material. During the same period, we purchased 72,475 gross tons of ferrous material. As of December 31, 2007, ferrous inventory consisted of 7,713 gross tons at a unit cost of \$239.65 per gross ton. As of December 31, 2006, ferrous inventory consisted of 9,400 gross tons at a unit cost of \$177.44 per gross ton. For the year ended December 31, 2007, the purchase price plus processing costs of ferrous material averaged \$201.13 per gross ton compared to \$157.25 per gross ton in 2006.

For the year ended December 31, 2007, we shipped 28,840,349 pounds of nonferrous material. During the same period, we purchased 24,314,589 pounds of nonferrous material. For the year ended December 31, 2006, we shipped 22,258,977 pounds of nonferrous material. During the same period, we purchased 20,362,645 pounds of nonferrous material. As of December 31, 2007, nonferrous inventory consisted of 1,992,954 pounds with a unit cost of \$1.3626 per pound. As of December 31, 2006, nonferrous inventory consisted of 1,601,554 pounds at a unit cost of \$0.960 per pound. For the year ended December 31, 2007, the purchase price plus processing costs of non-ferrous material has averaged \$1.363 per pound compared to \$0.960 per pound in 2006.

| <b>Year</b> | <b>Inventory Type</b> | <b>Gross Tons</b> | <b>Unit Cost</b> | <b>Amount</b> |
|-------------|-----------------------|-------------------|------------------|---------------|
| 2007        | Ferrous               | 7,713             | \$ 239.65        | \$1,848,445   |
| 2006        | Ferrous               | 9,400             | 177.44           | 1,667,937     |

| <b>Year</b> | <b>Inventory Type</b> | <b>Pounds</b> | <b>Unit Cost</b> | <b>Amount</b> |
|-------------|-----------------------|---------------|------------------|---------------|
| 2007        | Nonferrous            | 1,992,954     | 1.36             | \$ 2,715,703  |
| 2006        | Nonferrous            | 1,748,600     | 0.96             | 1,678,655     |

**Inventory Aging for the year ended December 31, 2007 (Days Outstanding)**

| Description | 1-30 | 31-60 | 61-90 | Over 90 | Total |
|-------------|------|-------|-------|---------|-------|
|-------------|------|-------|-------|---------|-------|

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|                       |             |             |            |           |             |
|-----------------------|-------------|-------------|------------|-----------|-------------|
| Equipment & parts     | \$ 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 |

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**Inventory aging for the year ended December 31, 2006 (Days Outstanding):**

| Description           | 1-30        | 31-60     | 61-90      | Over 90   | Total       |
|-----------------------|-------------|-----------|------------|-----------|-------------|
| Equipment & parts     | \$ 33,720   | \$ 22,480 | \$ -       | \$ -      | \$ 56,200   |
| Ferrous Materials     | 864,489     | 448,842   | 166,509    | 188,097   | 1,667,937   |
| Non-ferrous materials | 1,467,679   | 41,840    | 42,989     | 126,147   | 1,678,655   |
| Other                 | 25,434      | -         | -          | -         | 25,434      |
|                       | \$2,391,322 | \$513,162 | \$ 209,498 | \$314,244 | \$3,428,226 |

Accounts payable trade increased \$120,574 or 2.6% to \$4,665,631 as of December 31, 2007 compared to \$4,545,057 as of December 31, 2006. Recycling accounts payable increased \$33,750 or 2.5% to \$1,332,287 as of December 31, 2007 compared to \$1,298,537 as of December 31, 2006. This increase is primarily due to the increase in volume of commodity purchases at respective year-ends and increased commodity purchase prices of ferrous and nonferrous materials. Our accounts payable payment policy in the recycling segment is consistent between years.

CWS accounts payable increased \$94,580 or 3.1% to \$3,063,832 as of December 31, 2007 compared to \$2,969,252 as of December 31, 2006. This change is primarily due to new customers.

WESSCO accounts payable decreased \$120,784 or 58.8% to \$84,384 as of December 31, 2007 compared to \$205,168 as of December 31, 2006.

Working capital increased \$4,415,942 to \$7,940,040 as of December 31, 2007 compared to \$3,524,098 as of December 31, 2006. Net income of \$2,464,475, depreciation of \$1,954,023 and an increase in inventories of \$1,199,055 were positive contributors to working capital in 2007. During 2007, we used these positive working capital contributors to purchase property and equipment of \$2,169,829.

**Inflation and Prevailing Economic Conditions**

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

**Impact of Recently Issued Accounting Standards**

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Effective January 1, 2008, we adopted SFAS No. 157, Fair Value Measurements, for financial assets and liabilities. We carry certain of our financial assets and liabilities at fair value on a recurring basis. These financial assets and liabilities are composed of trading account assets, investment securities available for sale and various types of derivative instruments. In addition, we measure certain assets, such as goodwill and other long-lived assets, at fair value on a non-recurring basis to evaluate those assets for potential impairment. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

In accordance with SFAS No. 157, Fair Value Measurements, which we adopted effective January 1, 2008, 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 and foreign exchange 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.

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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, asset- and mortgage-backed securities and certain derivative instruments 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 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 December 31, 2008:

|                                 | Level 1     | Level 2        | Total         |
|---------------------------------|-------------|----------------|---------------|
| <b>Assets</b>                   |             |                |               |
| Cash and cash equivalents       | \$1,103,842 | -              | \$1,103,842   |
|                                 |             |                |               |
| <b>Liabilities</b>              |             |                |               |
| Long term debt                  | -           | \$ (9,367,877) | \$(9,367,877) |
| Derivative contract, net of tax |             | (792,236)      | (792,236)     |

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.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). SFAS 161 amends and expands the disclosure requirements in SFAS 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, the year beginning January 1, 2009 for ISA

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

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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. We maintain a \$10.0 million senior revolving credit facility with the Branch Banking and Trust Company which had no outstanding borrowings as of December 31, 2008. 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 which was 4.0% as of December 31, 2008. On February 11, 2009, we executed a promissory note with Branch Banking and Trust Company in the amount of \$12,000,000 for the purpose of financing our acquisition of inventory and fixed assets from Venture Metals, and real estate at 3409 Camp Ground Road, Louisville, Kentucky, from Luca Investments, LLC, an affiliate of Venture Metals. This note bears interest at the adjusted LIBOR rate of one month LIBOR plus 2.25% per annum with a floor of 4%. As of February 11, 2009, the applicable interest rate was 4% since the calculated rate was 2.67%. Based on our average anticipated

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borrowings under our credit agreements in fiscal 2009, 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 are exposed to market risk from changes in interest rates in the normal course of business. Our interest income and expense are most sensitive to changes in the general level of U.S. interest rates and the LIBOR rate. In order to manage this exposure, we use a combination of debt instruments, including the use of derivatives in the form of interest rate swap agreements. We do not enter into any derivatives for trading purposes. The use of the interest rate swap agreement is intended to convert the variable rate to a fixed rate.

**Item 8. Consolidated Financial Statements and Supplementary Data.**

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

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

None

**Item 9A(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 December 31, 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.



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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 report 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.

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Our management conducted an evaluation of the effectiveness of our internal control over financial reporting, based on the framework and criteria established in Internal Control -- Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management assessed the effectiveness of our internal control over financial reporting for the year ended December 31, 2008, and concluded that such internal control over financial reporting was effective as of December 31, 2008.

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

(c) Changes to internal control over financial reporting

There were no changes in ISA's internal control over financial reporting during the three months ended December 31, 2008 that have materially affected, or are reasonably likely to affect ISA's internal control over financial reporting.

**Item 9B. Other Information.**

None

**PART III**

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

**Item 11. Executive Compensation \***

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

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

**Item 14. Principal Accountant Fees and Services. \***

\* The information required by Items 10, 11, 12, 13 and 14 is or will be set forth in the definitive proxy statement relating to the 2008 Annual Meeting of Shareholders of ISA which is to be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after ISA's year end for the year covered by this report under the Securities Exchange Act of 1934, as amended. Such definitive proxy statement relates to an annual meeting of shareholders and the portions therefrom required to be set forth in this Form 10-K by Items 10, 11, 12, 13 and 14 are incorporated herein by reference pursuant to General Instruction G(3) to Form 10-K.

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**PART IV**

**Item 15. Exhibits and Consolidated Financial Statement Schedules.**

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

|   | <u>Page</u> |
|---|-------------|
| Report of Independent Registered Public Accounting Firms  | F-1         |
| Consolidated Balance Sheets as of December 31, 2008 and 2007  | F-3         |
| Consolidated Statements of Income for the years<br>ended December 31, 2008, 2007 and 2006               | F-4         |
| Consolidated Statements of Shareholders' Equity for the years ended<br>December 31, 2008, 2007 and 2006 | F-5         |
| Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006              | F-6         |
| Notes to Consolidated Financial Statements  | F-7         |

(a)(2) Consolidated Financial Statement Schedules.

|  |      |
|--|------|
| Schedule II--Valuation and Qualifying Accounts for the<br>years ended December 31, 2008, 2007 and 2006 | F-28 |
|--|------|

(a)(3) List of Exhibits

Exhibits filed with, or incorporated by reference herein, this report are identified in the Index to Exhibits appearing in this report. The Management Agreement and the Consulting Agreement required to be filed as exhibits to this Form 10-K pursuant to Item 14(c) are noted by an asterisk (\*) in the Index to Exhibits.

(b) Exhibits.

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

(c) Consolidated Financial Statement Schedules.

Schedule II--Valuation and Qualifying Accounts for the year ended December 31, 2008, 2007 and 2006 are incorporated by reference at page F-32 of the ISA Consolidated Financial Statements.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INDUSTRIAL SERVICES OF AMERICA, INC.

Dated: March 31, 2009

By :

/s/ Harry Kletter  
Harry Kletter, Chairman of the Board  
and Chief Executive Officer

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

| <u>Signature</u>                             | <u>Title</u>   | <u>Date</u>    |
|--|--|----------------|
| /s/ Harry Kletter<br>Harry Kletter           | Chairman of the Board and Chief<br>Executive Officer (Principal Executive<br>Officer)        | March 31, 2009 |
| /s/ Alan L. Schroering<br>Alan L. Schroering | Chief Financial Officer<br>(Principal Financial Officer and<br>Principal Accounting Officer) | March 31, 2009 |
| /s/ Orson Oliver<br>Orson Oliver             | Director   | March 31, 2009 |
| /s/ Roman Epelbaum<br>Roman Epelbaum         | Director   | March 31, 2009 |
| /s/ Albert Cozzi<br>Albert Cozzi             | Director   | March 31, 2009 |
| /s/ Richard Ferguson                         | Director   | March 31, 2009 |

Richard Ferguson

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**INDEX TO EXHIBITS**

| <b><u>Exhibit Number</u></b> | <b><u>Description of Exhibits</u></b>   |
|------------------------------|---|
| 3.1                          | ** Certificate of Incorporation of ISA is incorporated by reference to Exhibit 3.1 of ISA's report on Form 10-KSB for the year ended December 31, 1995.   |
| 3.2                          | ** Bylaws of ISA are incorporated by reference to Exhibit 3.2 of ISA's report on Form 10-KSB for the year ended December 31, 1995.  |
| 10.1                         | ** Independent Consulting Services Agreement, dated as of March 31, 1995, and executed on June 25, 1996, by and between ISA and Douglas I. Maxwell, III ("Maxwell"), is incorporated by reference to Exhibit 4(a) of ISA Statement on Form S-8 of the Registration, filed on June 26, 1996 (File No. 333-06915).      |
| 10.2                         | ** Confidential Information and Non-Competition Agreement Independent Contractor, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Maxwell, is incorporated by reference to Exhibit 10.1 of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06915).  |
| 10.3                         | ** Stock Option Agreement, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Maxwell, is incorporated by reference to Exhibit 4(b) of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06915).   |
| 10.4                         | ** Independent Consulting Services Agreement, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Neil C. Sullivan ("Sullivan"), is incorporated by reference to Exhibit 4(a) of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06909).                |
| 10.5                         | ** Confidential Information and Non-Competition Agreement Independent Contractor, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Sullivan, is incorporated by reference to Exhibit 10.1 of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06909). |
| 10.6                         | ** Stock Option Agreement, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Sullivan, is incorporated by reference to Exhibit 4(b) of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06909).  |
| 10.7                         | ** Acquisition of Assets Agreement, dated as of July 1, 1997, by and between ISA and The Metal Center set forth in an Asset Purchase Agreement, is incorporated by reference, as the sole Exhibit on Form 8-K of ISA, filed July 15, 1997 (File No. 0-20979).   |
| 10.8                         | ** Assignment of Contracts, dated September 4, 1997, by and between ISA and MGM Services, Inc. is incorporated by reference to Exhibit 10.11 of ISA's report on Form 10-K for the year ended December 31, 1997.   |
| 10.9                         | ** Employment Agreement, dated as of October 15, 1997, by and between ISA and Garber is incorporated by reference to Exhibit 10.12 of ISA's report on Form 10-K for the year ended December 31, 1997.   |
| 10.10                        | ** Lease Agreement, dated January 1, 1998, by and between ISA and K&R, is incorporated by reference herein, to Exhibit 10.10 on Form 8-K of ISA, filed March 3, 1998 (File No. 0-20979).*   |
| 10.11                        | ** Consulting Agreement, dated as of January 2, 1998, by and between ISA and K&R, is incorporated by reference herein, to Exhibit 10.11 on Form 8-K of ISA, filed March 3, 1998 (File No. 0-20979).*  |



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| <b><u>Exhibit Number</u></b> | <b><u>Description of Exhibits</u></b>  |
|------------------------------|--|
| 10.12                        | ** Amendment to Employment Agreement, dated as of February 5, 1998, by and between ISA and Garber, amending original agreement dated October 15, 1997 is incorporated by reference to Exhibit 10.15 of ISA's report on Form 10-K for the year ended December 31, 1997.   |
| 10.13                        | ** Stock Option Agreement, effective as of October 31, 1997, by and between ISA and Glenn Bierman is incorporated by reference herein to Exhibit 10.13 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.  |
| 10.14                        | ** Stock Option Agreement, effective as of October 27, 1997, by and between ISA and Sean Garber is incorporated by reference herein to Exhibit 10.14 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.  |
| 10.15                        | ** Stock Option Agreement, effective as of October 31, 1997, by and between ISA and Sean Garber is incorporated by reference herein to Exhibit 10.15 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.  |
| 10.16                        | ** Amendment No. 1 to Option Agreement, effective as of February 5, 1998, by and between ISA and Sean Garber is incorporated by reference herein to Exhibit 10.16 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.   |
| 10.17                        | ** Stock Option Agreement, effective as of February 16, 1998, by and between ISA and Harry Kletter is incorporated by reference herein to Exhibit 10.17 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.   |
| 10.18                        | ** Consulting Agreement, dated as of June 2, 1998, by and between ISA and Andrew M. Lassak is incorporated by reference herein to Exhibit 10.18 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.   |
| 10.19                        | ** Consulting Agreement, dated as of June 2, 1998, by and among ISA, Joseph Charles & Associates, Inc. and Andrew M. Lassak is incorporated by reference herein to Exhibit 10.19 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.  |
| 10.20                        | ** Asset Purchase Agreement, effective as of June 1, 1998, by and among ISA, ISA Indiana, Inc., R.J. Fitzpatrick Smelters, Inc., and R.K. Fitzpatrick and Cheryl Fitzpatrick is incorporated by reference herein to Exhibit 10.20 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.       |
| 10.21                        | ** Lease Agreement, effective June 1, 1998, by and between R.K. Fitzpatrick and Cheryl Fitzpatrick, R.J. Fitzpatrick Smelters, Inc., and ISA Indiana, Inc. is incorporated by reference herein to Exhibit 10.21 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.                         |
| 10.22                        | ** Environmental Indemnity Agreement, effective as of June 1, 1998, by and between R.K. Fitzpatrick and Cheryl Fitzpatrick, R.J. Fitzpatrick Smelters, Inc., and ISA Indiana, Inc. is incorporated by reference herein to Exhibit 10.22 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000. |
| 10.23                        | ** Promissory Note dated May 8, 1997, from Registrant to Bank of Louisville in the original principal amount of \$2,000,000.00 is incorporated by reference herein to Exhibit 10.23 of ISA's report on Form 10-K for the year ended December 31, 2000, as filed on March 30, 2001.   |
| 10.24                        | ** Loan Agreement dated November 30, 2000, by and between ISA and Bank of Louisville is incorporated by reference herein to Exhibit 10.24 of ISA's report on Form 10-K for the year ended December 31, 2000, as filed on March 30, 2001.   |
| 10.25                        | **   |

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Change in Terms Agreement dated November 30, 2000, by and between ISA and Bank of Louisville is incorporated by reference herein to Exhibit 10.25 of ISA's report on Form 10-K for the year ended December 31, 2000, as filed on March 30, 2001.

- 10.26    \*\*    Change in Terms Agreement dated March 26, 2001, by and between ISA and Bank of Louisville is incorporated by reference herein to Exhibit 10.26 of ISA's report on Form 10-K for the year ended December 31, 2000, as filed on March 30, 2001.
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| <u>Exhibit Number</u> | <u>Description of Exhibits</u>  |
|-----------------------|---|
| 10.27                 | ** Penske Lease and Purchase Agreement effective July 8, 2004, for three years at a rental of \$3,000 per month with an option to purchase for \$425,000.   |
| 10.28                 | ** Stock Option Agreement, dated June 11, 1996, by and between ISA and R. Jerry Falkner, is incorporated by reference to Exhibit 10.3 of ISA's report on Form 10-K for the year ended December 31, 1996.  |
| 10.29                 | ** Stock Option Agreement, dated March 1, 2000, by and between ISA and Andrew M. Lassak and related letter agreement dated November 3, 1999 is incorporated by reference herein to Exhibit 10.29 of ISA's report on Form 10-K for the year ended December 31, 2004, as filed on March 4, 2005.  |
| 10.30                 | ** Contract of Purchase, dated March 24, 2005, by and between the Southern States Cooperative, Incorporated and the Harry Kletter Family Limited Partnership (HKFLP), as assigned by assignment of contract of purchase, dated April 24, 2005 from HKFLP to ISA Real Estate, LLC is incorporated by reference herein to Exhibit 10.30 of ISA's report on Form 10-K for the year ended December 31, 2004, as filed on March 4, 2005. |
| 10.31                 | ** Lease, dated April 30, 2005, from ISA Real Estate, LLC to Southern States Cooperative, Incorporated is incorporated by reference herein to Exhibit 10.31 of ISA's report on Form 10-K for the year ended December 31, 2004, as filed on March 4, 2005.   |
| 10.32                 | ** Promissory Note for K&R, LLC in favor of ISA in the principal amount of \$302,160, dated March 25, 2006, and effective December 31, 2005, is incorporated by reference herein to Exhibit 10.32 of ISA's report on Form 10-K for the year ended December 31, 2005, as filed on March 31, 2006.  |
| 10.33                 | ** Loan and Security Agreement dated June 30, 2006, by and between ISA and Fifth Third Bank is incorporated by reference herein to Exhibit 10.33 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.   |
| 10.34                 | ** Promissory Note dated June 30, 2006, from ISA to Fifth Third Bank is incorporated by reference herein to Exhibit 10.34 of ISA's Report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.  |
| 10.35                 | ** Revolving Credit Facility Agreement dated December 22, 2006, by and between ISA and BB&T is incorporated by reference herein to Exhibit 10.35 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.   |
| 10.36                 | ** Promissory Note dated December 22, 2006 from ISA to BB&T is incorporated by reference herein to Exhibit 10.36 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.   |
| 10.37                 | ** Lease dated as of February 6, 2007, by and between Parks Wood Products, as lessor, and ISA Real Estate, LLC, as lessee, is incorporated by reference herein to Exhibit 10.37 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.  |
| 10.38                 | ** Sublease dated as of February 28, 2007 by and between ISA, as sub lessor, and Cohen Brothers of Lexington, Inc. as sublessee, is incorporated by reference herein to Exhibit 10.38 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.  |
| 10.39                 | ** Asset Purchase Agreement dated as of August 2, 2007, between ISA and Industrial Logistic Services, LLC, including exhibits thereto, is incorporated by reference herein to Exhibit 10.1 of ISA's report on Form 8-K for the event reported on August 2, 2007, as filed on August 8, 2007.  |
| 10.40                 | ** Executive Employment Agreement dated as of August 2, 2007, between ISA and Brian G. Donagy is incorporated by reference herein to Exhibit 10.2 of ISA's report on Form 8-K for the event reported on August 2, 2007, as filed on August 8, 2007.   |



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| <u>Exhibit Number</u> | <u>Description of Exhibits</u>   |
|-----------------------|--|
| 10.41                 | ** Employment Agreement dated effective as of April 4, 2007, between ISA and James K. Wiseman, III is incorporated by reference herein to Exhibit 10.3 of ISA's report on Form 8-K for the event reported on August 2, 2007, as filed on August 8, 2007.   |
| 10.42                 | ** Loan Agreement dated May 7, 2008, by and between ISA and Branch Banking and Trust Company is incorporated by reference herein to Exhibit 10.1 of ISA's Report on Form 8-K for the event reported on May 14, 2008, as filed on May 22, 2008.   |
| 10.43                 | ** Promissory Note in the amount of \$6,000,000 dated May 7, 2008, from ISA to Branch Banking and Trust Company is incorporated by reference herein to Exhibit 10.2 of ISA's Report on Form 8-K for the event reported on May 14, 2008, as filed on May 22, 2008.  |
| 10.44                 | ** Loan Agreement dated May 7, 2008, by and between ISA and Branch Banking and Trust Company is incorporated by reference herein to Exhibit 10.3 of ISA's Report on Form 8-K for the event reported on May 14, 2008, as filed on May 22, 2008.   |
| 10.45                 | ** Promissory Note in the amount of \$3,000,000 dated May 7, 2008, from ISA to Branch Banking and Trust Company is incorporated by reference herein to Exhibit 10.4 of ISA's Report on Form 8-K for the event reported on May 14, 2008, as filed on May 22, 2008.  |
| 10.46                 | ** Note Modification Agreement, dated October 15, 2008, in the amount of \$2,897,114.77 from ISA in favor of Branch Banking and Trust Company of North Carolina is incorporated by reference herein to Exhibit 10.1 of ISA's Report on Form 10-Q for the quarter ended September 30, 2008, as filed on November 5, 2008. |
| 10.47                 | ** Note Modification Agreement, dated October 15, 2008, in the amount of \$6,000,000 from ISA in favor of Branch Banking and Trust Company of North Carolina is incorporated by reference herein to Exhibit 10.2 of ISA's Report on Form 10-Q for the quarter ended September 30, 2008, as filed on November 5, 2008.    |
| 10.48                 | ** ISDA Master Agreement and Schedule, dated as December 22, 2006, between ISA and Branch Banking and Trust Company is incorporated by reference herein to Exhibit 10.3 of ISA's Report on Form 10-Q for the quarter ended September 30, 2008, as filed on November 5, 2008.   |
| 10.49                 | ** Swap Confirmation, dated October 20, 2008, between ISA and Branch Banking and Trust Company in the notional amount of \$2,897,114.77 is incorporated by reference herein to Exhibit 10.4 of ISA's Report on Form 10-Q for the quarter ended September 30, 2008, as filed on November 5, 2008.                         |
| 10.50                 | ** Swap Confirmation, dated October 20, 2008, between ISA and Branch Banking and Trust Company in the notional amount of \$6,000,000 is incorporated by reference herein to Exhibit 10.5 of ISA's Report on Form 10-Q for the quarter ended September 30, 2008, as filed on November 5, 2008.                            |
| 11                    | Statement of Computation of Earnings Per Share (See Note 9 to Notes to Consolidated Financial Statements).   |
| 16                    | Letter from Crowe Chizek and Company, LLC dated April 28, 2005, regarding change in certifying accountant is incorporated by reference herein to Exhibit 16 of ISA's report on Form 8-K/A, as filed on April 28, 2005.   |
| 31.1                  | Rule 13a-14(a) Certification of Harry Kletter for the Form 10-K for the year ended December 31, 2008.  |
| 31.2                  | Rule 13a-14(a) Certification of Alan Schroering for the Form 10-K for the year ended December 31, 2008.  |

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**Exhibit  
Number**

**Description of Exhibits**

32.1 Section 1350 Certification of Harry Kletter and Alan Schroering for the Form 10-K for the year ended December 31, 2008.

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

\*\*Previously filed.

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**INDUSTRIAL SERVICES OF AMERICA, INC.**

**AND SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2008, 2007 and 2006

INDUSTRIAL SERVICES OF AMERICA, INC.

AND SUBSIDIARIES

Louisville, Kentucky

**CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2008, 2007 and 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Industrial Services of America, Inc. and Subsidiaries

Louisville, Kentucky

We have audited the accompanying consolidated balance sheets of Industrial Services of America, Inc. and Subsidiaries as of December 31, 2008 and 2007 and the related consolidated statements of income, shareholders' equity and cash flows for each of the years in the three year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Industrial Services of America, Inc. and Subsidiaries as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2008, in conformity with U. S. generally accepted accounting principles. Also, in our opinion, the related consolidated financial statements schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

Mountjoy & Bressler, LLP

Louisville, Kentucky

March 31, 2009

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See accompanying notes to consolidated financial statements.

1.

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INDUSTRIAL SERVICES OF AMERICA, INC.  
AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
December 31, 2008 and 2007

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|  | <u>2008</u>   | <u>2007</u>   |
|--|---------------|---------------|
| <b>ASSETS</b>  |               |               |
| Current assets   |               |               |
| Cash   | \$ 1,103,842  | \$ 1,501,685  |
| Income tax receivable  | 36,016        | 100,737       |
| Accounts receivable - trade (after allowance for doubtful<br>accounts of \$490,000 in 2008 and \$100,000 in 2007) (Note 1) | 3,811,484     | 6,764,851     |
| Net investment in sales-type leases (Note 5)   | 54,629        | 60,364        |
| Inventories (Note 1)   | 4,371,348     | 4,627,281     |
| Deferred income taxes (Note 4)   | 912,337       | 141,636       |
| Other  | 126,902       | 318,496       |
| Total current assets   | 10,416,558    | 13,515,050    |
| Shredder system construction in progress   | 6,547,902     | 2,173,076     |
| Net property and equipment (Note 1)  | 10,895,477    | 9,537,345     |
| Other assets   |               |               |
| Net investment in sales-type leases (Note 5)   | 71,222        | 125,851       |
| Notes receivable - related party (Note 6)  | 167,594       | 204,053       |
| Goodwill (Note 1)  | 560,005       | 560,005       |
| Other assets   | 132,672       | 169,142       |
|  | 931,493       | 1,059,051     |
|  | \$ 28,791,430 | \$ 26,284,522 |

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See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC.  
AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
December 31, 2008 and 2007

**LIABILITIES AND SHAREHOLDERS' EQUITY**

## Current liabilities

|   |            |            |
|---|------------|------------|
| Current maturities of long term debt (Note 3)               | \$ 857,863 | \$ 338,913 |
| Current maturities of capital lease obligations (Note 8)    | 80,771     | 133,675    |
| Accounts payable  | 3,701,895  | 4,665,631  |
| Income tax payable  | 566,025    | -          |
| Liability for legal settlements (Note 11)                   | 1,037,165  | 10,000     |
| Interest rate swap agreement liability, net of tax (Note 1) | 792,236    | -          |
| Other current liabilities                                   | 391,731    | 426,791    |
| Total current liabilities                                   | 7,427,686  | 5,575,010  |

## Long-term liabilities

|                                    |           |           |
|------------------------------------|-----------|-----------|
| Long-term debt (Note 3)            | 8,510,014 | 8,393,784 |
| Capital lease obligations (Note 8) | 20,798    | 101,569   |
| Deferred income taxes (Note 4)     | 491,715   | 194,721   |
|                                    | 9,022,527 | 8,690,074 |

## Commitments (Note 8)

## Shareholders' equity

|  |               |                    |
|--|---------------|--------------------|
| Common stock, \$.005 par value: 10,000,000 shares authorized,<br>4,295,000 shares issued in 2008 and 2007,<br>3,575,292 shares outstanding in 2008 and 3,620,899 in 2007<br>respectively | 21,475        | 21,475             |
| Additional paid-in capital   | 3,742,373     | 3,599,624          |
| Retained earnings  | 10,601,102    | 9,434,733          |
| Accumulated other comprehensive loss   | (475,342)     | -                  |
| Treasury stock at cost, 719,708 shares in 2008 and 674,101 in 2007   | (1,548,391)   | <u>(1,036,394)</u> |
|  | 12,341,217    | 12,019,438         |
|  | \$ 28,791,430 | \$ 26,284,522      |

See accompanying notes to consolidated financial statements.



INDUSTRIAL SERVICES OF AMERICA, INC.  
AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
Years ended December 31, 2008, 2007 and 2006







2008

2007

2006

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|   |                     |                     |                     |
|---|---------------------|---------------------|---------------------|
| Revenue from services                         | \$ 18,182,726       | \$ 17,234,194       | \$ 15,387,241       |
| Revenue from product sales                    | 81,859,765          | 59,721,347          | 46,694,807          |
| <b>Total Revenue</b>                          | <b>100,042,491</b>  | <b>76,955,541</b>   | <b>62,082,048</b>   |
| Cost of goods sold for services               | 16,502,452          | 15,233,788          | 13,984,314          |
| Cost of goods sold for product sales          | 68,639,348          | 50,639,372          | 40,284,368          |
| Inventory adjustment for lower cost or market | 1,228,352           | -                   | -                   |
| Reduction of cost of goods sold               | -                   | (858,249)           | (1,272,241)         |
| <b>Total Cost of goods sold</b>               | <b>86,370,152</b>   | <b>65,014,911</b>   | <b>52,996,441</b>   |
| Selling, general and administrative expenses  | 10,215,904          | 7,766,915           | 5,609,959           |
| <b>Income before other income (expense)</b>   | <b>3,456,435</b>    | <b>4,173,715</b>    | <b>3,475,648</b>    |
| Other income (expense)                        |                     |                     |                     |
| Interest expense                              | (372,444)           | (290,689)           | (212,722)           |
| Interest income                               | 85,598              | 119,762             | 195,662             |
| Gain (loss) on sale of assets                 | 34,842              | (3,696)             | 22,990              |
| Provision for lawsuit settlement (Note 11)    | (990,000)           | -                   | -                   |
| Other income, net                             | 336,802             | 22,741              | 32,930              |
|   | (905,202)           | (151,882)           | 38,860              |
| <b>Income before income taxes</b>             | <b>2,551,233</b>    | <b>4,021,833</b>    | <b>3,514,508</b>    |
| Income tax provision (Note 4)                 | 1,023,635           | 1,458,000           | 1,325,929           |
| <b>Net income</b>                             | <b>\$ 1,527,598</b> | <b>\$ 2,563,833</b> | <b>\$ 2,188,579</b> |
| Basic earnings per share                      | \$ .43              | \$ .71              | \$ .61              |
| Diluted earnings per share                    | \$ .43              | \$ .71              | \$ .61              |

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC.  
AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
Years ended December 31, 2008, 2007 and 2006

|  | <u>Common Stock</u> |               | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | <u>Treasury Stock</u> |              | <u>Total</u> |
|--|---------------------|---------------|----------------------------------|----------------------|---|-----------------------|--------------|--------------|
|  | <u>Shares</u>       | <u>Amount</u> |                                  |                      |   | <u>Shares</u>         | <u>Cost</u>  |              |
| <b>Balance as of<br/>January 1, 2006</b>                 | 4,255,000           | \$ 21,275     | \$ 3,113,819                     | \$ 5,046,411         | \$ -  | (688,592)             | \$ (731,750) | \$ 7,449,755 |
| Treasury stock<br>purchase                               | -                   | -             | -                                | -                    | -   | (5,509)               | (16,338)     | (16,338)     |
| Exercise of stock<br>options and related<br>tax benefits | 40,000              | 200           | 80,997                           | -                    | -   | 40,000                | 43,112       | 124,309      |
| Net income   | -                   | -             | -                                | 2,188,579            | -   | -                     | -            | 2,188,579    |
| <b>Balance as of<br/>December 31, 2006</b>               | 4,295,000           | 21,475        | 3,194,816                        | 7,234,990            | -   | (654,101)             | (704,976)    | 9,746,305    |
| Cash dividend  | -                   | -             | -                                | (364,090)            | -   | -                     | -            | (364,090)    |
| Repurchase of<br>common stock                            | -                   | -             | -                                | -                    | -   | (40,000)              | (352,974)    | (352,974)    |
| Stock bonus  | -                   | -             | 194,244                          | -                    | -   | 20,000                | 21,556       | 215,800      |
| Tax benefits related<br>to common stock<br>options       | -                   | -             | 210,564                          | -                    | -   | -                     | -            | 210,564      |
| Net income   | -                   | -             | -                                | 2,563,833            | -   | -                     | -            | 2,563,833    |
| <b>Balance as of<br/>December 31, 2007</b>               | 4,295,000           | 21,475        | 3,599,624                        | 9,434,733            | -   | (674,101)             | (1,036,394)  | 12,019,438   |
| Net unrealized loss<br>on derivative<br>instruments      | -                   | -             | -                                | -                    | (475,342)                                     | -                     | -            | (475,342)    |

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|  |           |           |              |               |              |           |                |              |
|--|-----------|-----------|--------------|---------------|--------------|-----------|----------------|--------------|
| 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)    |
| <b>Net income</b>                          | -         | -         | -            | 1,527,598     | -            | -         | -              | 1,527,598    |
| <b>Balance as of<br/>December 31, 2008</b> | 4,295,000 | \$ 21,475 | \$ 3,742,373 | \$ 10,601,102 | \$ (475,342) | (719,708) | \$ (1,548,391) | \$12,341,217 |

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See accompanying notes to consolidated financial statements.

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INDUSTRIAL SERVICES OF AMERICA, INC.  
AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Years ended December 31, 2008, 2007 and 2006

|   | <u>2008</u>  | <u>2007</u>  | <u>2006</u>  |
|---|--------------|--------------|--------------|
| <b>Cash flows from operating activities</b>                               |              |              |              |
| Net income  | \$ 1,527,598 | \$ 2,563,833 | \$ 2,188,579 |
| Adjustments to reconcile net income to net cash from operating activities |              |              |              |
| Depreciation  | 2,122,167    | 1,954,023    | 1,745,905    |
| Inventory write-down  | 1,228,352    | -            | -            |
| Stock distribution to employees   | 161,400      | 215,800      | -            |
| Deferred income taxes   | (156,813)    | (59,589)     | (222,511)    |
| Tax benefit of stock options exercised                                    | -            | 210,564      | -            |
| Provision for doubtful accounts   | 390,000      | -            | 50,000       |
| (Gain) loss on sale of property and equipment                             | (34,842)     | 3,696        | (22,990)     |
| Change in assets and liabilities  |              |              |              |
| Receivables   | 2,563,367    | (1,738,410)  | (573,596)    |
| Net investment in sales-type leases                                       | 60,364       | 50,586       | 65,797       |
| Inventories   | (972,419)    | (1,199,055)  | (939,617)    |
| Other assets  | 292,785      | (337,735)    | 110,987      |
| Accounts payable  | (963,736)    | 120,574      | (3,737,224)  |
| Other current liabilities   | 1,558,130    | (1,147,988)  | 117,747      |
| Net cash from operating activities  | 7,776,353    | 636,299      | (1,216,923)  |
| <b>Cash flows from investing activities</b>                               |              |              |              |
| Proceeds from sale of property and equipment                              | 126,283      | 57,300       | 81,700       |
| Purchases of property and equipment                                       | (3,571,740)  | (2,169,829)  | (2,166,331)  |
| Payments for shredder system  | (4,374,826)  | (2,173,076)  | -            |
| Payments from related party   | 36,459       | 34,513       | 25,824       |
| Net cash from investing activities  | (7,783,824)  | (4,251,092)  | (2,058,807)  |
| <b>Cash flows from financing activities</b>                               |              |              |              |
| Payments on capital lease obligation                                      | (133,675)    | (337,959)    | (161,626)    |
| Proceeds from long-term debt  | 8,773,555    | 7,850,000    | 10,710,875   |
| Payments on long-term debt  | (8,138,375)  | (3,010,306)  | (7,770,984)  |
| Proceeds from exercise of common stock options                            | -            | -            | 124,309      |
| Payment of cash dividend  | (364,190)    | (364,090)    | -            |
| Purchases of common stock   | (527,687)    | (352,974)    | (16,338)     |
| Net cash from financing activities  | (390,372)    | 3,784,671    | 2,886,236    |
| Net change in cash  | (397,843)    | 169,878      | (389,494)    |

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|  |                     |                     |                     |
|--|---------------------|---------------------|---------------------|
| Cash at beginning of year  | 1,501,685           | 1,331,807           | 1,721,301           |
| <b>Cash at end of year</b>   | <b>\$ 1,103,842</b> | <b>\$ 1,501,685</b> | <b>\$ 1,331,807</b> |
| Supplemental disclosure of cash flow information                       |                     |                     |                     |
| Cash paid for interest   | \$ 372,444          | \$ 332,745          | \$ 212,722          |
| Cash paid for taxes  | 617,675             | 2,593,479           | 604,652             |
| Supplemental disclosure of noncash investing and financing activities: |                     |                     |                     |
| Equipment purchased under capital leases                               | -                   | -                   | 186,178             |
| Equipment purchased through seller financing                           | -                   | 1,010,040           | -                   |

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See accompanying notes to consolidated financial statements.

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INDUSTRIAL SERVICES OF AMERICA, INC.  
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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES



**Nature of Business:** The recycling division of Industrial Services of America, Inc. and its subsidiaries (ISA) purchases and sells ferrous and nonferrous materials and fiber scrap on a daily basis at our two wholly owned subsidiaries, ISA Recycling, LLC (located in Louisville, Kentucky) and ISA Indiana, Inc. (serving southern Indiana). ISA also provides products and services to meet the waste management needs of its customers related to ferrous, non-ferrous and corrugated scrap recycling, management services and waste equipment sales and rental. Our management services division represents contracts with retail, commercial and industrial businesses to handle their waste disposal needs, primarily by subcontracting with commercial waste hauling and disposal companies. Our customers and subcontractors are located throughout the United States and Canada. ISA's waste equipment sales and services division (WESSCO) installs or repairs equipment and rental equipment on a same day basis. Each of our segments bills separately for its products or services. Generally, services and products are not bundled for sale to individual customers. The products or services have value to the customer on a standalone basis.



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





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



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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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





Accounts Receivable and Allowance for Doubtful Accounts: Accounts receivable consists primarily of amounts due from customers from product and brokered sales. The allowance for doubtful accounts totaled \$490,000 at December 31, 2008 and \$100,000 at December 31, 2007. Our determination of the allowance for doubtful accounts includes a number of factors, including the age of the balance, past experience with the customer account, changes in collection patterns and general economic and industry conditions. Interest is not normally charged on receivables. Potential credit losses from our significant customers could adversely affect our results of operations or financial condition. While we believe our allowance for doubtful accounts is adequate, changes in economic conditions or any weakness in the steel and metals industry could adversely impact our future earnings. We charge off losses to the allowance when we deem further collection efforts will not provide additional recoveries.



Major Customer: We currently have no significant customer concentration.



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



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





Estimates: In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management must make estimates and assumptions. These estimates and assumptions affect the amounts reported for assets, liabilities, revenues and expenses, as well as affecting the disclosures provided. Future results could differ from the current estimates.



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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)



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 recognize inventory write-down when the market value, based upon current market pricing, falls below recorded value or when the estimated volume is less than the recorded volume of the inventory. We would record the loss in cost of goods sold in the period during which we identified the loss.





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

We believe that the long-term fundamentals supporting the prices for recycled metals remain positive; however, given the current trends in the market for ferrous and nonferrous metal, we believe that fiscal 2009 selling prices will be lower than those seen in 2008. Due to the high level of uncertainty regarding the economic environment, our past trends of sales volumes may not be indicative of expected volumes in fiscal 2009.

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 by gross ton. Processing costs in ferrous inventory totaled \$535,874 at December 31, 2008 and \$432,377 at December 31, 2007. Processing costs in non-ferrous inventory totaled \$237,436 at December 31, 2008 and \$66,912 at December 31, 2007. Ferrous inventory of \$2,162,149 at December 31, 2008 was comprised of \$418,035 in raw materials and \$1,744,114 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 \$2,033,154 at December 31, 2008 was comprised of \$362,065 in raw materials and \$1,671,089 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 \$3,098,870 in general and administrative processing costs to cost of sales for the year ended December 31, 2008 and \$2,671,089 for the year ended December 31, 2007.



In the fourth quarter 2008, demand and prices for inventory decreased due to reduced demand for scrap and recycled metal arising from weaker economic conditions, which led to a reduction in ferrous sales volumes and average nonferrous selling prices. In addition, continued weak demand and the impact of declines in anticipated future selling prices which outpaced the decline in inventory costs, results in ISA recording a non-cash net realizable value ("NRV") inventory write-down of \$1.2 million.







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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

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 December 31, 2008 and 2007 consist of the following:

2008

2007

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|                                   |              |              |
|-----------------------------------|--------------|--------------|
| Ferrous materials                 | \$ 2,162,149 | \$ 1,848,445 |
| Non-ferrous materials, high grade | 2,033,154    | 2,689,635    |
| Non-ferrous materials, low grade  | -            | 26,068       |
| Waste Equipment Machinery         | 95,675       | 36,498       |
| Other                             | 80,370       | 26,635       |
|                                   | \$4,371,349  | \$4,627,281  |

Property and Equipment: Property and equipment are stated at cost and depreciated on a straight line basis over the estimated useful lives of the related property. Assets under capital lease obligations are amortized over the term of the capital lease.

Property and equipment as of December 31, 2008 and 2007 consist of the following:

|  | <u>Life</u> | <u>2008</u>   | <u>2007</u>  |
|--|-------------|---------------|--------------|
| Land   |             | \$ 2,265,310  | \$ 1,676,810 |
| Equipment and vehicles                         | 1-10 years  | 12,351,205    | 11,189,279   |
| Office equipment                               | 1-7 years   | 1,686,177     | 1,560,081    |
| Rental equipment                               | 3-5 years   | 5,098,708     | 4,720,483    |
| Building and leasehold improvements            | 5-40 years  | 3,568,083     | 2,788,560    |
|  |             | 24,969,483    | 21,935,213   |
| Less accumulated depreciation and amortization |             | 14,074,006    | 12,397,868   |
|  |             | \$ 10,895,477 | \$ 9,537,345 |

Depreciation expense for the years ended December 31, 2008, 2007 and 2006 was \$2,122,167, \$1,954,023 and \$1,745,905. Of the \$2,122,167 depreciation expense recognized in 2008, \$1,480,734 was recorded in cost of sales, and \$641,433 was recorded in general and administrative expense.



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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

|      |             |
|------|-------------|
| 2009 | \$1,877,564 |
| 2010 | 1,511,200   |
| 2011 | 1,077,500   |
| 2012 | 589,437     |
| 2013 | 161,487     |
|      | \$5,217,188 |

Goodwill and Other Intangible Assets: Goodwill and certain intangible assets are no longer amortized but are assessed at least annually for impairment with any such impairment recognized in the period identified. We perform our annual goodwill impairment test internally at December 31 and at the level of the recycling reporting unit to which all the goodwill is related. We determine whether to impair goodwill by comparing the fair value of the recycling reporting unit as a whole (the present value of expected cash flows) to its carrying value including goodwill. Since the recycling reporting unit's fair value exceeds its carrying value, no further computations are required.

Derivative and Hedging Activities: SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and subsequent amendments (hereinafter collectively referred to as SFAS No. 133), contains numerous requirements including the recognition of derivative instruments in the financial statements at fair value. Derivatives that are not hedges must be adjusted to fair value through the statement of operations. If the derivative meets the requirements for hedge accounting in accordance with SFAS No. 133, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the corresponding change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income (loss) until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in the statement of operations.



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

Accumulated Other Comprehensive Income (Loss): Comprehensive income is net income plus certain other items that are recorded directly to shareholders' equity. Amounts included in other accumulated comprehensive loss for our derivative instruments are recorded net of the related income tax effects. The following table gives further detail regarding the composition of other accumulated comprehensive income (loss) at December 31, 2008 and 2007.

|   | <b>12/31/2008</b> | <b>12/31/2007</b> |
|---|-------------------|-------------------|
| Net unrealized losses on derivative instruments, net of tax | \$ 475,342        | \$ -              |
| Total accumulated other comprehensive income (loss)         | \$ 475,342        | \$ -              |

Income Taxes: Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Statement of Cash Flows: The statement of cash flows has been prepared using a definition of cash that includes deposits with original maturities of three months or less.

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

|  | <u>2008</u>  | <u>2007</u>  | <u>2006</u>  |
|--|--------------|--------------|--------------|
| <u>Net income (loss)</u>                 |              |              |              |
| Net income, as reported                  | \$ 1,527,598 | \$ 2,563,833 | \$ 2,188,579 |
| <u>Basic earnings (loss) per share</u>   |              |              |              |
| As reported                              | \$ .43       | \$ .71       | \$ .61       |
| <u>Diluted earnings (loss) per share</u> |              |              |              |
| As reported                              | \$ .43       | \$ .71       | \$ .61       |

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

On January 1, 2006, we adopted SFAS No. 123R (Revised 2004), *Share-Based Payment*, using the modified prospective method. The impact of adopting SFAS 123R on our consolidated results of operations depends on the level of future option grants and the fair value of the options granted at such future dates, as well as the vesting periods provided by such awards. Existing outstanding options did not result in additional compensation expense upon adoption of SFAS 123R since all outstanding options were fully vested.

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Following is a summary of stock option activity and number of shares reserved for outstanding options for the years ended December 31, 2008, 2007 and 2006:

|  | <u>Number<br/>of<br/>Shares</u> | <u>Weighted<br/>Average<br/>Exercise<br/>Price<br/>Per Share</u> | <u>Exercise<br/>Price Per<br/>Share</u> | <u>Maximum<br/>Remaining<br/>Term of<br/>Options<br/>Granted</u> | <u>Weighted<br/>Average<br/>Grant Date<br/>Fair Value<br/>of Options</u> |
|--|---------------------------------|--|---|--|--|
| <b>Balance as of January 1, 2006</b>   | 20,000                          | \$1.25   | \$1.25                                  | 1 to 3<br>years  | \$1.21   |
| Expired                                | <u>(20,000)</u>                 | \$1.25   | \$1.25                                  |  |  |
| <b>Balance as of December 31, 2006</b> | -                               | -  |   |  |  |
| <b>Balance as of December 31, 2007</b> | -                               | -  |   |  |  |
| <b>Balance as of December 31, 2008</b> | -                               | -  |   |  |  |

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



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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Fair Value of Financial Instruments: We estimate the fair value of our financial instruments using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, prepayments and other factors. Changes in assumptions or market conditions could significantly affect these estimates. As of December 31, 2008, the estimated fair value of our financial instruments approximated book value. The fair value of our debt approximates its carrying value because the majority of our debt bears a floating rate of interest based on the prime rate. There is no readily available market by which to determine fair market value of our fixed term debt; however, based on existing interest rates and prevailing rates as of each year end, we have determined that the fair value of our fixed rate debt approximates book value.

**Impact of Recently Issued Accounting Standards:**

Effective January 1, 2008, we adopted SFAS No. 157, Fair Value Measurements, for financial assets and liabilities. We carry certain of our financial assets and liabilities at fair value on a recurring basis. These financial assets and liabilities are composed of trading account assets, investment securities available for sale and various types of derivative instruments. In addition, we measure certain assets, such as goodwill and other long-lived assets, at fair value on a non-recurring basis to evaluate those assets for potential impairment. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

In accordance with SFAS No. 157, Fair Value Measurements, which we adopted effective January 1, 2008, 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 and foreign exchange 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, asset- and mortgage-backed securities and certain derivative instruments with little or no market activity and a resulting lack of price transparency.

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

|                                 | Level 1     | Level 2       | Total         |
|---------------------------------|-------------|---------------|---------------|
| <b>Assets</b>                   |             |               |               |
| Cash and cash equivalents       | \$1,103,842 | -             | \$1,103,842   |
|                                 |             |               |               |
| <b>Liabilities</b>              |             |               |               |
| Long term debt                  | -           | \$(9,367,877) | \$(9,367,877) |
| Derivative contract, net of tax | -           | (792,236)     | (792,236)     |

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.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). SFAS 161 amends and expands the disclosure requirements in SFAS 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, the year beginning January 1, 2009 for ISA

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## **NOTE 2 - NOTE PAYABLE TO BANK**

On February 11, 2009, we executed a promissory note, loan agreement and related security documents with Branch Banking and Trust Company in the amount of \$12,000,000 for the purpose of financing our acquisition of inventory and fixed assets from Venture Metals, and real estate at 3409 Camp Ground Road, Louisville, Kentucky, from Luca Investments, LLC, an affiliate of Venture Metals (Note 14). The maturity date of this note is February 11, 2010. Interest is payable monthly commencing March 11, 2009, and the note bears interest at the adjusted LIBOR rate of one month LIBOR plus 2.25% per annum with a floor of 4%. As of February 11, 2009, the applicable interest rate was 4% since the calculated rate was 2.67%. All ISA's assets (except rental fleet equipment) secure this note. As a result of this note and related loan documents, ISA and BB&T undertook amendments to existing security agreements related to the \$10,000,000 borrowing line from BB&T, dated December 22, 2006 (see below), a BB&T Bankcard Corporation Commercial Card Application and BB&T Bankcard Corporation Commercial Card Plan Agreement, executed December 9, 2003 and December 8, 2003, and a \$6,000,000 equipment loan to purchase the ISA shredder system and complementary facility improvements, dated May 7, 2008, so as to provide that the security for each of the above loans also secures the \$12,000,000 loan of February 11, 2009.

This \$12,000,000 loan provides for advances of up to 80% of ISA's eligible accounts receivable, 80% of eligible real estate, 35% of eligible raw materials inventory, and up to 100% of ISA's net book value of eligible equipment less any outstanding indebtedness on the equipment. This \$12,000,000 loan contains restrictive, affirmative, negative and financial covenants. Events of default include failure to promptly pay principal or interest on the note, proof of a false or misleading representation or warranty in any loan document, default on the performance by ISA of any other obligation or indebtedness when due or in connection with money borrowed, breach of any covenant, condition or agreement made under any of the loan documents, bankruptcy of ISA, final judgment for payment of money remaining undischarged for 30 days after judgment against ISA which is not otherwise covered by insurance, BB&T in good faith deeming itself unsafe or insecure, or the failure of any lien or security interest granted to BB&T by ISA to have the priority agreed to by BB&T on the date granted or otherwise becomes unperfected or invalid for any reason. Remedies include the declaration by BB&T of the balances of the ISA notes to be immediately due and payable, the pledge of additional collateral, the taking of the collateral as security for the note, or the exercise of any other remedies under the Kentucky Uniform Commercial Code.

Since ISA has entered into this \$12,000,000 loan partially to reimburse itself for the acquisition of the inventory from Venture Metals under the inventory purchase agreement, and its proceeds are available for payment upon exercise of the option to purchase the fixed assets of Venture Metals and also to purchase real estate in the event ISA elects to purchase such real estate, then this \$12,000,000 facility becomes a source of payment for the purchase of those various assets.

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**NOTE 2 - NOTE PAYABLE TO BANK** (Continued)

We 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 January 1, 2012, providing 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, and is secured by all our assets (except rental fleet equipment). As of December 31, 2008, we had paid off this credit facility in full.

**NOTE 3 - LONG-TERM DEBT**

Long-term debt as of December 31, 2008 and 2007 consists of the following:

|  | <u>2008</u> | <u>2007</u>  |
|--|-------------|--------------|
| Note payable to Fifth Third Bank secured by our rental fleet equipment with a fixed interest rate of 6.83% and monthly payments of \$23,047. The maturity date under this agreement is June 2011 with a ten-year amortization schedule.  | \$ -        | \$ 1,779,585 |
| Revolving credit facility with BB&T secured by all assets except for rental fleet equipment with a variable interest rate of Libor plus 2.25% and no required monthly principal payments. The maturity date under this agreement is January 1, 2012.   | -           | 6,000,000    |
| Note payable to Branch Banking and Trust Company in the amount of \$3.0 million secured by our rental fleet equipment with a fixed interest rate of 5.65%. The repayment terms are principal and interest paid monthly commencing on November 7, 2008 with one final payment of all remaining principal and accrued interest due at maturity on May 7, 2013. The maturity date under this agreement is May 2013.     | 2,838,094   | -            |
| Note payable to Branch Banking and Trust Company in the amount of \$6.0 million secured by our shredder system assets with a fixed interest rate of 5.89%. The repayment terms are principal and interest paid monthly commencing on November 7, 2008 with one final payment of all remaining principal and accrued interest due at maturity on April 7, 2014. The maturity date under this agreement is April 2014. | 5,000,000   | -            |
| Note payable to Branch Banking and Trust Company in the amount of \$609,900 secured by a crane with a fixed interest rate of 5.89%. The repayment terms are principal and interest paid monthly beginning December 1, 2008 with one final payment of all remaining principal and accrued interest due at maturity in December 2013.  | 602,153     | -            |
| Note payable to Paccar Financial Corp. in the amount of \$163,655 secured by two Kenworth trucks. Payments are \$3,395.36 per month with an effective interest rate of 6.5%. The maturity date under this agreement is September 2011.   | 153,469     | -            |
| Note payable to ILS for various assets including tractor trailers, trucks and containers. The repayment terms are \$20,000 per month for 60 months at a seven percent (7%) interest rate. The maturity date under this agreement is August 2012.   | 774,161     | 953,112      |

|                         |              |              |
|-------------------------|--------------|--------------|
|                         | 9,367,877    | 8,732,697    |
| Less current maturities | 857,863      | 338,913      |
|                         | \$ 8,510,014 | \$ 8,393,784 |

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INDUSTRIAL SERVICES OF AMERICA, INC.  
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**NOTE 3 - LONG-TERM DEBT** (Continued)

The annual maturities of long-term debt as of December 31, 2008 are as follows:

|              |                    |
|--------------|--------------------|
| 2009         | \$ 857,863         |
| 2010         | 1,022,449          |
| 2011         | 1,115,618          |
| 2012         | 1,028,798          |
| Thereafter   | 5,343,149          |
| <b>Total</b> | <b>\$9,367,877</b> |

On May 14, 2008, we executed a 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. 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 December 31, 2008, we were in compliance with all restrictive covenants.

On May 14, 2008, we executed a loan agreement with Branch Banking and Trust Company in the amount of \$6.0 million to finance the purchase of our shredder system and complementary 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 complementary 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

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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. 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 December 31, 2008, we were in compliance with all restrictive covenants.

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 also paid ILS \$100,000 cash as a portion of the purchase price at the time of execution of the asset purchase agreement. We recorded a note payable of \$1,010,040 with an outstanding balance at December 31, 2008 of \$774,161.

We entered into three interest rate swap agreements swapping variable rates for fixed rates. The first swap agreement covers \$6 million in debt and commenced October 15, 2008 and matures on April 7, 2014. The second swap agreement covers approximately \$2.9 million in debt and commenced October 15, 2008 and matures on May 7, 2013. The third swap agreement covers \$606,027 in debt and commenced October 22, 2008 and matures on October 22, 2013. The three swap agreements fix our interest rate at approximately 5.8%. At December 31, 2008, we recorded the estimated fair value of the three swaps as approximately \$792,000. Accounting rules require us to recognize all derivatives on the balance sheet at estimated fair value. We have designated this agreement as a cash flow hedge.

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**NOTE 4 - INCOME TAXES**

The income tax provision (benefit) consists of the following for the years ended December 31, 2008, 2007 and 2006:

|         |                              | <u>2008</u> | <u>2007</u>  | <u>2006</u>  |
|---------|------------------------------|-------------|--------------|--------------|
| Federal |                              |             |              |              |
|         | Current                      | \$ 912,289  | \$ 1,254,133 | \$ 1,178,483 |
|         | Deferred                     | (128,610)   | (51,814)     | (174,958)    |
|         |                              | 783,679     | 1,202,319    | 1,003,525    |
| State   |                              |             |              |              |
|         | Current                      | 268,159     | 356,943      | 369,957      |
|         | Refundable state tax credits | -           | (99,358)     | -            |
|         | Deferred                     | (28,203)    | (1,904)      | (47,553)     |
|         |                              | 239,956     | 255,681      | 322,404      |
|         |                              | \$1,023,635 | \$ 1,458,000 | \$ 1,325,929 |

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

|  | <u>2008</u> | <u>2007</u>  | <u>2006</u>  |
|--|-------------|--------------|--------------|
| Federal income tax at statutory rate                           | \$ 868,584  | \$ 1,352,831 | \$ 1,194,933 |
| State and local income taxes, net of federal income tax effect | 158,370     | 202,927      | 212,787      |
| Permanent differences  | 8,855       | (173,485)    | (43,702)     |
| Stock options exercised  | -           | 210,564      | -            |
| Refundable state tax credits                                   | -           | (99,358)     | -            |
| Other differences, net   | (12,174)    | (35,479)     | (38,089)     |
|  | \$1,023,635 | \$1,458,000  | \$1,325,929  |

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**NOTE 4 - INCOME TAXES** (Continued)

Significant components of the Company's deferred tax liabilities and assets as of December 31, 2008 and 2007 are as follows:

|                                       | <u>2008</u>  | <u>2007</u>  |
|---------------------------------------|--------------|--------------|
| Deferred tax liabilities              |              |              |
| Tax depreciation in excess of book    | \$ (764,263) | \$ (202,313) |
| Interest rate swap                    | 316,894      | -            |
| Tax amortization in excess of book    | (160,533)    | (137,600)    |
| Gross deferred tax liabilities        | \$ (607,902) | \$ (339,913) |
| Deferred tax assets                   |              |              |
| Property taxes                        | 42,945       | 38,077       |
| Allowance for doubtful accounts       | 210,700      | 43,867       |
| Book amortization in excess of tax    | 116,187      | 145,192      |
| Inventory capitalization              | 69,809       | 59,692       |
| Reserve for CWS                       | 129,000      | -            |
| Litigation settlement                 | 425,700      | -            |
| Other                                 | 34,183       | -            |
| Gross deferred tax assets             | 1,028,524    | 286,828      |
| Net deferred tax assets (liabilities) | \$ 420,622   | \$ (53,085)  |

**NOTE 5 - SALES-TYPE LEASES**

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

Future lease payments receivable under sales-type leases at December 31, 2008 are as follows:

|                                     |          |
|-------------------------------------|----------|
| 2009                                | \$66,720 |
| 2010                                | 74,355   |
| Minimum lease payments receivable   | 141,075  |
| Less unearned income                | 15,224   |
| Net investment in sales-type leases | 125,851  |
| Less current portion                | (54,629) |

\$ 71,222

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INDUSTRIAL SERVICES OF AMERICA, INC.  
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**NOTE 6 - RELATED PARTY TRANSACTIONS**

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

|   | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|-------------|-------------|-------------|
| <b><u>Balance sheet accounts:</u></b>         |             |             |             |
| Accounts receivable                           | \$ -        | \$ -        | \$ -        |
| Notes receivable                              | \$ 182,868  | \$ 204,053  | \$ 238,566  |
| Deposits (included in other long-term assets) | \$ 62,106   | \$ 62,106   | \$ 62,106   |
| <b><u>Income statement activity:</u></b>      |             |             |             |
| Rent expense                                  | \$ 505,272  | \$ 505,272  | \$ 505,272  |
| Consulting fees                               | \$ 240,000  | \$ 240,000  | \$ 240,000  |

ISA leases its corporate offices, processing property and buildings in Louisville, Kentucky for \$42,106 per month from K&R pursuant to the K&R Lease. Deposits include one month of rent in advance in the amount of \$42,106. In 2004, we paid for repairs totaling \$302,160 that we made to the buildings and property that we lease from K&R, located at 7100 Grade Lane, Louisville, Kentucky. K&R executed an unsecured promissory note, dated March 25, 2006, but effective December 31, 2004, to us for the principal sum of \$302,160. In January 2006, K&R began making payments on the promissory note of principal only in ninety-six (96) monthly installments of \$3,147.50 each. Failure of K&R to make any payment when due under this note within fifteen (15) days of its due date shall constitute a default. After the fifteen day period, the note shall bear interest at a rate equal to fifteen percent (15%) per annum and we have the right to exercise our remedies to collect full payment of the note.

In an addendum to the K&R lease as of January 1, 2006, the rent was increased \$4,000 as a result of the improvements made to the property in 2004. For years 2008 and 2007, the payments to K&R by the Company of \$4,000 for additional rent and the payment from K&R to the Company of \$3,897.66 for the promissory note were offset.



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**NOTE 6 - RELATED PARTY TRANSACTIONS (Continued)**

We entered into an agreement with K&R for consulting services related to the scrap metal and paper recycling operations and related equipment sales and services. The agreement requires that we make annual payments to K&R of \$240,000 in equal monthly installments of \$20,000. Deposits include one month of consulting services in advance in the amount of \$20,000. Our Chairman is compensated through these consulting fees. In 2008, we extended this consulting agreement for one year according to the terms of the contract.

**NOTE 7 - EMPLOYEE RETIREMENT PLAN**

We maintain a defined contribution retirement plan under Section 401(k) of the Internal Revenue Code which covers substantially all employees. Eligible employees may contribute a maximum of 15% of their annual salary. Under the plan, we match 25% of each employee's voluntary contribution up to 6% of their gross salary. The expense under the plan for 2008, 2007 and 2006 was \$46,814, \$42,810 and \$33,438, respectively.

**NOTE 8 - LEASE COMMITMENTS**

Operating Leases:

We lease our Louisville, Kentucky facility from a related party (see Note 6) under an operating lease expiring December 2012. The rent was adjusted in January 2008 per the agreement to monthly payments of \$48,500 through December 2012. In addition, the Company is also responsible for real estate taxes, insurance, utilities and maintenance expense.

We lease a facility in Dallas, Texas for management services operations. The agreement provided that monthly payments of \$2,457 were paid through September 2006. The lease was renewed effective October 1, 2007 for a period of two years with monthly payments of \$2,750. The Company also leases other machinery and equipment under operating leases which expire through August 2012.

We lease a facility in Lexington, Kentucky for \$4,500 per month; the lease terminates December 31, 2012. We have subleased this property for a term commencing March 1, 2007 and ending December 31, 2012 for \$4,500 per month.

If for any reason the sublessee defaults, we remain liable for the remainder of the lease payments through December 31, 2012.

On February 6, 2007, we leased 7.7 acres of real property, including a 38,000 square foot warehouse and a 400 square foot office, in Pineville, Louisiana for \$5,250 per month for twenty-four months beginning March 1, 2007 and ending February 28, 2009, with an option to purchase the property for a purchase price of \$575,000. On January 18, 2008, we sold our position in this property, including the lease and the option, for \$25,000.

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**NOTE 8 - LEASE COMMITMENTS** (Continued)

Future minimum lease payments for operating leases as of December 31, 2008 are as follows:

|                               |              |
|-------------------------------|--------------|
| 2009                          | \$ 684,882   |
| 2010                          | 639,679      |
| 2011                          | 636,000      |
| 2012                          | 636,000      |
| 2013                          | -            |
| Future minimum lease payments | \$ 2,596,561 |

Total rent expense for the years ended December 31, 2008, 2007 and 2006 was \$876,312, \$832,733 and \$784,954, 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 September 2011.

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                     | \$ 978,677  | \$ 1,881,607 |
| Less accumulated depreciation | 269,960     | 273,005      |
|                               | \$ 708,717  | \$ 1,608,602 |

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 December 31, 2008.

|   |           |
|---|-----------|
| 2009  | \$ 80,771 |
| 2010  | 20,798    |
| Total future minimum lease payments         | 101,569   |
| Less amount representing interest           | -         |
| Present value of net minimum lease payments | 101,569   |
| Less current portion                        | (80,771)  |
| Capital Lease Obligations                   | \$ 20,798 |

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**NOTE 9 - CASH DIVIDEND**

The Board of Directors, at its regular annual meeting June 26, 2008, declared a cash dividend payment of ten cents (\$0.10) per common share of stock for shareholders of record as of July 31, 2008, with a payment date of August 21, 2008.

The Board of Directors, at our May 15, 2007 annual meeting, declared a cash dividend payment of ten cents per share for shareholders of record as of June 15, 2007 with a payment date of July 20, 2007.

**NOTE 10 - PER SHARE DATA**

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

|   | <u>2008</u>  | <u>2007</u>  | <u>2006</u>  |
|---|--------------|--------------|--------------|
| <b>Basic earnings per share</b>                               |              |              |              |
| Net income  | \$ 1,527,598 | \$ 2,563,833 | \$ 2,188,579 |
| Weighted average shares outstanding                           | 3,595,813    | 3,638,215    | 3,602,872    |
| Basic earnings per share                                      | \$ .43       | \$ .71       | \$ .61       |
| <b>Diluted earnings per share</b>                             |              |              |              |
| Net income  | \$ 1,527,598 | \$ 2,563,833 | \$ 2,188,579 |
| Weighted average shares outstanding                           | 3,595,813    | 3,638,215    | 3,602,872    |
| Add dilutive effect of assumed exercising<br>of stock options | -            | -            | 10,218       |
| Diluted average shares outstanding                            | 3,595,813    | 3,638,215    | 3,613,090    |
| Diluted earnings per share                                    | \$ .43       | \$ .71       | \$ .61       |

**NOTE 11 - LEGAL PROCEEDINGS**



In May 2006, All American Recycling, known as 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 R.D. Burton and Donna Burton v. Industrial Services of America, Inc., et. al., Jefferson Circuit Court, Case No. 06-C-04701), as further described in the Form 10-Q for the period ended September 30, 2008. On January 14, 2009, a Jefferson County, Kentucky Circuit Court jury awarded AAR approximately \$990,000 primarily for a breach by ISA of the agreement that required ISA to provide referrals to AAR. ISA reserved for the loss in an approximate amount of \$990,000 in its financial statements for the year ended December 31, 2008, and we paid the settlement amount of \$990,000 in February 2009. On February 2, 2009, the parties to the lawsuit entered into a settlement agreement that resulted in the dismissal of the case with prejudice on February 17, 2009 and provided for , among other items, the payment of the jury

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**NOTE 11 - LEGAL PROCEEDINGS** (Continued)

award on February 9, 2009, by the defendants to the plaintiffs. In addition, AAR agreed to vacate by March 31, 2009 the premises at Grade Lane, Louisville, Kentucky, that AAR subleased from ISA. AAR also agreed to be subject to a non-competition and non-solicitation term beginning February 2, 2009, for one year, wherein AAR has agreed not to engage in competition with, or solicit business or employees from, ISA during that period and within a distance of 2.5 miles of the ISA Grade Lane facilities.

After AAR leaves the Grade Lane facilities, ISA intends to relocate the stainless steel inventory operations of Venture Metals from the Camp Ground Road location to the vacated premises on Grade Lane. ISA then intends to renovate the Camp Ground Road facilities to become a full-service yard for the purpose of providing ferrous, non-ferrous and stainless material for the Grade Lane operations.

On January 4, 2007, Lennox Industries, Inc., a commercial heating and air-conditioning manufacturer, filed suit against us in the Arkansas County, Arkansas Circuit Court in the case styled Lennox Industries, Inc. v. Industrial Services of America, Inc., Case No. CV-2007-004. Because of settlement negotiations, Lennox did not serve us until May 23, 2007. Lennox alleges that we breached a 2001 contract with Lennox where we agreed to act as agent for Lennox, by our failure to properly evaluate, categorize, classify and value the production scrap and waste of Lennox, thereby brokering such products at prices below market value. Lennox also alleges negligence and breach of fiduciary duty related to the same alleged failure. Lennox is taking the position that ISA had a duty to obtain a price that was consistent with the materials being sold on their behalf that it failed to show a proper duty of care in its dealings with Lennox. On July 9, 2008, Lennox Amended its Complaint to add a cause of action based on fraud and misrepresentation (civil fraud). The Lennox complaint does not state any specific monetary damages. We have filed an answer denying all claims. The litigation is in its discovery phase. We currently believe that the claims have no merit.

Lennox is claiming they are owed in excess of \$1.9MM. The case lends itself to the filing of a Partial Motion for Summary Judgment. Such a motion is currently being prepared and will be filed no less than 45 days prior to the Trial. The case is currently in discovery and scheduled for trial July 15-17, 2009.

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

**NOTE 12 - SEGMENT INFORMATION**



The Company's 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 two 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.



The Company's 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.













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**NOTE 12 - SEGMENT INFORMATION** (Continued)





The accounting policies of the three segments are the same as those described in the summary of significant accounting policies (Note 1). We evaluate segment performance based on gross profit or loss and the evaluation process for each segment includes only direct expenses and selling, general and administrative costs, omitting any other income and expense and income taxes.



ISA Recycling

CWS

WESSCO

Other

Segment  
Totals

2008

|                    |               |    |   |    |   |    |   |               |
|--------------------|---------------|----|---|----|---|----|---|---------------|
| Recycling revenues | \$ 79,545,562 | \$ | - | \$ | - | \$ | - | \$ 79,545,562 |
|--------------------|---------------|----|---|----|---|----|---|---------------|

Equipment sales,  
services

|                      |   |   |           |   |           |
|----------------------|---|---|-----------|---|-----------|
| and leasing revenues | - | - | 2,314,203 | - | 2,314,203 |
|----------------------|---|---|-----------|---|-----------|



|                 |   |            |   |   |            |
|-----------------|---|------------|---|---|------------|
| Management fees | - | 18,182,726 | - | - | 18,182,726 |
|-----------------|---|------------|---|---|------------|

|                    |              |              |           |   |              |
|--------------------|--------------|--------------|-----------|---|--------------|
| Cost of goods sold | (69,027,772) | (16,502,452) | (839,928) | - | (86,370,152) |
|--------------------|--------------|--------------|-----------|---|--------------|

Selling, general and

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|                         |             |             |           |             |              |
|-------------------------|-------------|-------------|-----------|-------------|--------------|
| administrative expenses | (5,396,460) | (1,530,606) | (418,415) | (2,870,423) | (10,215,904) |
|-------------------------|-------------|-------------|-----------|-------------|--------------|

|                       |              |            |              |               |              |
|-----------------------|--------------|------------|--------------|---------------|--------------|
| Segment profit (loss) | \$ 5,121,330 | \$ 149,668 | \$ 1,055,860 | \$(2,870,423) | \$ 3,456,435 |
|-----------------------|--------------|------------|--------------|---------------|--------------|

Segment

ISA Recycling

CWS

WESSCO

Other

Totals

2008



|      |            |           |      |            |              |
|------|------------|-----------|------|------------|--------------|
| Cash | \$ 237,914 | \$ 15,132 | \$ - | \$ 850,796 | \$ 1,103,842 |
|------|------------|-----------|------|------------|--------------|

|                     |           |           |        |        |           |
|---------------------|-----------|-----------|--------|--------|-----------|
| Accounts receivable | 2,084,702 | 1,669,842 | 44,594 | 12,346 | 3,811,484 |
|---------------------|-----------|-----------|--------|--------|-----------|

|             |           |   |         |   |           |
|-------------|-----------|---|---------|---|-----------|
| Inventories | 4,255,802 | - | 115,546 | - | 4,371,348 |
|-------------|-----------|---|---------|---|-----------|

Net property and  
equipment,

|                              |            |       |           |           |            |
|------------------------------|------------|-------|-----------|-----------|------------|
| including shredder<br>system | 13,736,644 | 5,449 | 1,627,225 | 2,074,061 | 17,443,379 |
|------------------------------|------------|-------|-----------|-----------|------------|

|          |         |   |   |   |         |
|----------|---------|---|---|---|---------|
| Goodwill | 560,005 | - | - | - | 560,005 |
|----------|---------|---|---|---|---------|

|              |         |        |       |           |           |
|--------------|---------|--------|-------|-----------|-----------|
| Other assets | 179,393 | 13,952 | 3,001 | 1,305,026 | 1,501,372 |
|--------------|---------|--------|-------|-----------|-----------|

|                |               |              |              |              |               |
|----------------|---------------|--------------|--------------|--------------|---------------|
| Segment assets | \$ 21,054,460 | \$ 1,704,375 | \$ 1,790,366 | \$ 4,242,229 | \$ 28,791,430 |
|----------------|---------------|--------------|--------------|--------------|---------------|







ISA Recycling

CWS

WESSCO

Other

Totals

2007

|                    |               |    |   |    |   |    |   |               |
|--------------------|---------------|----|---|----|---|----|---|---------------|
| Recycling revenues | \$ 57,603,071 | \$ | - | \$ | - | \$ | - | \$ 57,603,071 |
|--------------------|---------------|----|---|----|---|----|---|---------------|

Equipment sales,  
services

|                      |   |   |           |   |           |
|----------------------|---|---|-----------|---|-----------|
| and leasing revenues | - | - | 2,118,276 | - | 2,118,276 |
|----------------------|---|---|-----------|---|-----------|

|                 |   |            |   |   |            |
|-----------------|---|------------|---|---|------------|
| Management fees | - | 17,234,194 | - | - | 17,234,194 |
|-----------------|---|------------|---|---|------------|



|                    |              |              |           |   |              |
|--------------------|--------------|--------------|-----------|---|--------------|
| Cost of goods sold | (50,407,072) | (14,375,539) | (232,300) | - | (65,014,911) |
|--------------------|--------------|--------------|-----------|---|--------------|

Selling, general and

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|                         |             |             |             |             |             |
|-------------------------|-------------|-------------|-------------|-------------|-------------|
| administrative expenses | (2,963,996) | (1,048,347) | (1,316,435) | (2,438,137) | (7,766,915) |
|-------------------------|-------------|-------------|-------------|-------------|-------------|

|                       |              |              |            |               |              |
|-----------------------|--------------|--------------|------------|---------------|--------------|
| Segment profit (loss) | \$ 4,232,003 | \$ 1,810,308 | \$ 569,541 | \$(2,438,137) | \$ 4,173,715 |
|-----------------------|--------------|--------------|------------|---------------|--------------|



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**NOTE 12 - SEGMENT INFORMATION** (Continued)

Segment



ISA Recycling

CWS

WESSCO

Other

Totals

2007

|      |            |           |      |              |              |
|------|------------|-----------|------|--------------|--------------|
| Cash | \$ 390,868 | \$ 15,229 | \$ - | \$ 1,095,588 | \$ 1,501,685 |
|------|------------|-----------|------|--------------|--------------|

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|                     |           |           |        |        |           |
|---------------------|-----------|-----------|--------|--------|-----------|
| Accounts receivable | 4,813,971 | 1,868,100 | 69,960 | 12,820 | 6,764,851 |
|---------------------|-----------|-----------|--------|--------|-----------|

|             |           |   |        |   |           |
|-------------|-----------|---|--------|---|-----------|
| Inventories | 4,574,648 | - | 52,633 | - | 4,627,281 |
|-------------|-----------|---|--------|---|-----------|

Net property and

|           |           |        |           |           |           |
|-----------|-----------|--------|-----------|-----------|-----------|
| equipment | 5,694,134 | 27,089 | 1,851,916 | 1,964,206 | 9,537,345 |
|-----------|-----------|--------|-----------|-----------|-----------|

|          |         |   |   |   |         |
|----------|---------|---|---|---|---------|
| Goodwill | 560,005 | - | - | - | 560,005 |
|----------|---------|---|---|---|---------|



|              |           |        |         |         |           |
|--------------|-----------|--------|---------|---------|-----------|
| Other assets | 2,572,723 | 18,249 | 198,491 | 503,892 | 3,293,355 |
|--------------|-----------|--------|---------|---------|-----------|

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|                |               |              |              |              |               |
|----------------|---------------|--------------|--------------|--------------|---------------|
| Segment assets | \$ 18,606,349 | \$ 1,928,667 | \$ 2,173,000 | \$ 3,576,506 | \$ 26,284,522 |
|----------------|---------------|--------------|--------------|--------------|---------------|

Segment

ISA Recycling

CWS

WESSCO

Other

Totals

2006

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|                    |               |    |   |    |   |    |   |               |
|--------------------|---------------|----|---|----|---|----|---|---------------|
| Recycling revenues | \$ 44,967,023 | \$ | - | \$ | - | \$ | - | \$ 44,967,023 |
|--------------------|---------------|----|---|----|---|----|---|---------------|

Equipment sales,  
services

|                      |   |   |           |   |           |
|----------------------|---|---|-----------|---|-----------|
| and leasing revenues | - | - | 1,727,784 | - | 1,727,784 |
|----------------------|---|---|-----------|---|-----------|



|                 |   |            |   |   |            |
|-----------------|---|------------|---|---|------------|
| Management fees | - | 15,387,241 | - | - | 15,387,241 |
|-----------------|---|------------|---|---|------------|

|                    |              |              |           |   |              |
|--------------------|--------------|--------------|-----------|---|--------------|
| Cost of goods sold | (39,448,957) | (12,712,073) | (835,411) | - | (52,996,441) |
|--------------------|--------------|--------------|-----------|---|--------------|

Selling, general and

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|                         |             |             |           |             |             |
|-------------------------|-------------|-------------|-----------|-------------|-------------|
| administrative expenses | (1,431,251) | (1,479,302) | (542,433) | (2,156,973) | (5,609,959) |
|-------------------------|-------------|-------------|-----------|-------------|-------------|

|                       |              |              |            |                |              |
|-----------------------|--------------|--------------|------------|----------------|--------------|
| Segment profit (loss) | \$ 4,086,815 | \$ 1,195,866 | \$ 349,940 | \$ (2,156,973) | \$ 3,475,648 |
|-----------------------|--------------|--------------|------------|----------------|--------------|



INDUSTRIAL SERVICES OF AMERICA, INC.  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008, 2007 and 2006









**NOTE 13 - SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

1st

2nd

3rd

4th

Year

2008

|         |              |              |              |              |               |
|---------|--------------|--------------|--------------|--------------|---------------|
| Revenue | \$26,083,395 | \$34,511,085 | \$28,837,828 | \$10,610,183 | \$100,042,491 |
|---------|--------------|--------------|--------------|--------------|---------------|

|                      |   |   |   |             |             |
|----------------------|---|---|---|-------------|-------------|
| Inventory write-down | - | - | - | (1,228,352) | (1,228,352) |
|----------------------|---|---|---|-------------|-------------|

Income before other



|                  |           |           |           |             |           |
|------------------|-----------|-----------|-----------|-------------|-----------|
| income (expense) | 1,884,895 | 2,814,162 | 1,940,416 | (3,183,038) | 3,456,435 |
|------------------|-----------|-----------|-----------|-------------|-----------|

|                  |   |   |   |           |           |
|------------------|---|---|---|-----------|-----------|
| Legal settlement | - | - | - | (990,000) | (990,000) |
|------------------|---|---|---|-----------|-----------|

|            |           |           |           |             |           |
|------------|-----------|-----------|-----------|-------------|-----------|
| Net income | 1,086,551 | 1,662,632 | 1,280,115 | (2,501,700) | 1,527,598 |
|------------|-----------|-----------|-----------|-------------|-----------|

|                          |      |      |      |        |      |
|--------------------------|------|------|------|--------|------|
| Basic earnings per share | 0.30 | 0.46 | 0.36 | (0.69) | 0.43 |
|--------------------------|------|------|------|--------|------|

|                            |      |      |      |        |      |
|----------------------------|------|------|------|--------|------|
| Diluted earnings per share | 0.30 | 0.46 | 0.36 | (0.69) | 0.43 |
|----------------------------|------|------|------|--------|------|

1st

2nd

3rd

4th

Year

2007

|         |              |              |              |              |              |
|---------|--------------|--------------|--------------|--------------|--------------|
| Revenue | \$17,904,749 | \$19,528,096 | \$17,928,810 | \$21,593,886 | \$76,955,541 |
|---------|--------------|--------------|--------------|--------------|--------------|



Income before other

|                  |           |           |         |         |           |
|------------------|-----------|-----------|---------|---------|-----------|
| income (expense) | 1,298,974 | 1,406,383 | 652,605 | 815,753 | 4,173,715 |
|------------------|-----------|-----------|---------|---------|-----------|

|            |         |         |         |         |           |
|------------|---------|---------|---------|---------|-----------|
| Net income | 793,080 | 821,299 | 383,159 | 566,295 | 2,563,833 |
|------------|---------|---------|---------|---------|-----------|

|                          |      |      |      |      |      |
|--------------------------|------|------|------|------|------|
| Basic earnings per share | 0.22 | 0.22 | 0.11 | 0.16 | 0.71 |
|--------------------------|------|------|------|------|------|

|                            |      |      |      |      |      |
|----------------------------|------|------|------|------|------|
| Diluted earnings per share | 0.22 | 0.22 | 0.11 | 0.16 | 0.71 |
|----------------------------|------|------|------|------|------|

1st

2nd

3rd

4th

Year

2006

|         |              |              |              |              |               |
|---------|--------------|--------------|--------------|--------------|---------------|
| Revenue | \$14,484,020 | \$17,702,634 | \$15,331,235 | \$14,564,159 | \$ 62,082,048 |
|---------|--------------|--------------|--------------|--------------|---------------|



Income before other

|                  |         |           |         |           |           |
|------------------|---------|-----------|---------|-----------|-----------|
| income (expense) | 688,693 | 1,007,525 | 511,167 | 1,268,263 | 3,475,648 |
|------------------|---------|-----------|---------|-----------|-----------|

|            |         |         |         |         |           |
|------------|---------|---------|---------|---------|-----------|
| Net income | 416,526 | 602,757 | 439,568 | 729,728 | 2,188,579 |
|------------|---------|---------|---------|---------|-----------|

|                          |      |      |      |      |      |
|--------------------------|------|------|------|------|------|
| Basic earnings per share | 0.12 | 0.17 | 0.12 | 0.20 | 0.61 |
|--------------------------|------|------|------|------|------|

|                            |      |      |      |      |      |
|----------------------------|------|------|------|------|------|
| Diluted earnings per share | 0.12 | 0.17 | 0.12 | 0.20 | 0.61 |
|----------------------------|------|------|------|------|------|

**NOTE 14 - SUBSEQUENT EVENTS**

On January 13, 2009 we entered into an inventory purchase agreement with Venture Metals, LLC and its members, Steve Jones, Jeff Valentine and Carlos Corona, under which we agreed to pay to Venture Metals \$8,846,794 for inventory comprised of stainless steel and high temperature alloys, which we verified as to weight. We funded the purchase of the inventory through our line of credit with Branch Banking & Trust Company.

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INDUSTRIAL SERVICES OF AMERICA, INC.  
AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008, 2007 and 2006









**NOTE 14 - SUBSEQUENT EVENTS** (Continued)

Under the agreement, we also have the right to retain the use of the property located at 3409 Camp Ground Road, Louisville, Kentucky, the site of the Venture Metals business that Venture Metals leases from Luca Investments, LLC, an affiliate of Venture Metals, owned 50% each by Messrs. Jones and Valentine. We have the right to use the facilities located on those premises for a period not to exceed two years from the date of the agreement for a monthly rental of \$15,000. Messrs. Jones, Valentine and Corona are our employees.

On February 18, 2009, and effective February 11, 2009, ISA entered into a lease agreement with Venture Metals, LLC, leasing from Venture Metals all of the fixed assets of Venture Metals, located at 3409 Camp Ground Road, Louisville, Kentucky. ISA has agreed to pay rent in the amount of \$15,000 per month commencing March 1, 2009, with a pro rata amount to be paid for the period from February 11, 2009 through February 28, 2009. The term of the lease ends of February 28, 2011 and is automatically renewable for a period of 12 months unless terminated 30 days prior to the scheduled expiration date by ISA. ISA assumes the risk of loss related to the fixed assets and is indemnifying Venture Metals related to the manufacture, sale, purchase and use of the fixed assets except for the gross negligence or willful misconduct of Venture Metals. ISA is responsible for all taxes and insurance on the fixed assets.

Venture Metals has represented that certain fixed assets are subject to prior leases with third party equipment lessors and may be subject to liens under financing provided to Venture Metals. Venture Metals has agreed to remain primarily liable for these obligations and shall not incur any additional financing on the fixed assets or permit any future liens or encumbrances to be placed on the fixed assets. The lease has no force and effect with respect to any fixed asset that is subject to a prior lease or lien for financing if the existence of the lease is a default under any document evidencing such prior lease or financing.

Events of default include the failure of the lessee to pay rent, the failure to perform or breach any of the covenants for a period of 30 days after notice from Venture Metals, the removal, sale or subletting of any fixed asset without the consent of Venture Metals, the creation, incurrence or suffering to exist of any mortgage, lien or other encumbrance upon the fixed assets by ISA, except for any lien or encumbrance created as a result of ISA's prior financing with and granting of a security interest to Branch Banking and Trust Company, the bankruptcy or insolvency of ISA, or any material misrepresentation or warranty made by ISA under the lease. As a consequence of any such default, Venture Metals may declare the entire amount of rent due and payable for the lease term, take immediate possession of the fixed assets, sell or lease any of the fixed assets, demand payment of all reasonable costs or upon notice to ISA, terminate the lease.

ISA may sublease the fixed assets to an affiliate without the consent of Venture Metals. ISA, as long as no event of default under the lease has occurred and is continuing, has the option at any time and upon 5 days prior written notice to Venture Metals to purchase all, but not less than all, of the fixed assets for approximately \$1,498,885, less all rent paid through the date ISA notifies Venture Metals of ISA's election to exercise the purchase option. In addition, ISA has the right upon the 5 days' prior written notice to terminate the lease without further rent obligation owed from ISA to Venture Metals.

In the event ISA acquires the fixed assets through the purchase option, Venture Metals must satisfy any outstanding obligations Venture Metals has with respect to the fixed assets. The fixed assets include equipment such as cranes, loaders, scales, forklifts, computers, including computer software, furniture, and certain leasehold improvements to the property at 3409 Camp Ground Road, Louisville, Kentucky.

In connection with an inventory purchase agreement, dated January 13, 2009, between ISA and Venture Metals, ISA verified the amount of and on February 11, 2009, paid for the remaining inventory of stainless steel and high temperature alloys sold by Venture Metals to ISA, thus concluding the sale of all of the applicable inventory assets to ISA.

**SUPPLEMENTARY INFORMATION**

INDUSTRIAL SERVICES OF AMERICA, INC.  
AND SUBSIDIARIES

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS  
Years ended December 31, 2008, 2007 and 2006







| <u>Description</u> | <u>Balance at<br/>Beginning<br/>of Period</u> | <u>Additions<br/>Charged to<br/>Costs and<br/>Expenses</u> | <u>Deductions *</u> | <u>Balance at<br/>End of Period</u> |
|--------------------|---|--|---------------------|-------------------------------------|
|--------------------|---|--|---------------------|-------------------------------------|

Allowance for doubtful



|                           |            |            |      |            |
|---------------------------|------------|------------|------|------------|
| from accounts receivable) | \$ 100,000 | \$ 390,000 | \$ - | \$ 490,000 |
|---------------------------|------------|------------|------|------------|

Allowance for doubtful



|                           |            |      |      |            |
|---------------------------|------------|------|------|------------|
| from accounts receivable) | \$ 100,000 | \$ - | \$ - | \$ 100,000 |
|---------------------------|------------|------|------|------------|

Allowance for doubtful





|                           |           |           |      |            |
|---------------------------|-----------|-----------|------|------------|
| from accounts receivable) | \$ 50,000 | \$ 50,000 | \$ - | \$ 100,000 |
|---------------------------|-----------|-----------|------|------------|

Accrual for legal

|                      |    |   |            |    |   |            |
|----------------------|----|---|------------|----|---|------------|
| settlements for 2008 | \$ | - | \$ 990,000 | \$ | - | \$ 990,000 |
|----------------------|----|---|------------|----|---|------------|

\* uncollected amounts written off, net of recoveries

