

INDUSTRIAL SERVICES OF AMERICA INC /FL
Form 10-K
April 01, 2013

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 the Fiscal Year Ended December 31, 2012

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

For the transition period from _____ to _____

Commission File Number 0-20979

INDUSTRIAL SERVICES OF AMERICA, INC.

(Exact Name of Registrant as specified in its Charter)

Florida

59-0712746

(State or other jurisdiction of
Incorporation or Organization)

(IRS Employer Identification No.)

7100 Grade Lane, PO Box 32428

Louisville, Kentucky 40232

(Address of principal executive offices)

(502) 368-1661

(Registrant's Telephone Number, Including Area Code)

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

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

Common Stock, \$0.0033 par value

(Title of class)

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

Yes No

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

Indicate by check mark whether the registrant (1) has filed all Reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

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

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

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

Aggregate market value of the 4,067,485 shares of voting Common Stock held by non-affiliates of the registrant at the closing sales price on June 30, 2012: \$20,215,400.

Number of shares of Common Stock, \$0.0033 par value, outstanding as of the close of business on April 1, 2013: 6,944,267

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2013 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 recycler of stainless steel, ferrous, and non-ferrous scrap and provider of waste services. Although we have two principal business segments, recycling and waste services, we are primarily focusing our attention now and in the future towards our recycling business. The recycling segment collects, purchases, processes and sells stainless steel, ferrous and non-ferrous scrap metal to steel mini-mills, integrated steel makers, foundries and refineries. We purchase ferrous and non-ferrous scrap metal primarily from industrial and commercial generators of steel, iron, aluminum, copper, stainless steel and other metals as well as from scrap dealers and retail customers who deliver these materials directly to our facilities. We process scrap metal through our shredding, sorting, cutting, and baling operations. Within the recycling segment, our alloys division specializes in the purchasing, processing and sale of stainless steel, nickel-based and high-temperature alloys. Our non-ferrous scrap recycling operations consist primarily of collecting, sorting and processing various grades of copper, aluminum and brass. Our used automobile yard primarily purchases automobiles so that retail customers can locate and remove used parts for purchase.

The waste services segment provides waste management services including contract negotiations with service providers, centralized billing, invoice auditing and centralized dispatching. Waste services also rents, leases, sells, and services waste handling and recycling equipment, such as trash compactors and balers to end-user customers.

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

Additional financial information about our segments can be found in Part II, Item 8, "Notes to Consolidated Financial Statements" and related notes included elsewhere in this Form 10-K.

Available Information

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

ISA Recycling Operating Division

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

On July 2, 2012, we opened the ISA Pick.Pull.Save used automobile yard, which is considered a new product line within the recycling segment. We purchase automobiles for the yard through auctions, automobile purchase programs with various suppliers, and general scrap purchases. Retail customers locate and remove used parts for purchase from automobiles within the yard. Fuel, Freon, tires and certain core automobile parts are also sold to various vendors for additional revenue. All automobiles are shredded and sold as scrap metal after a specified time period in the yard.

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, cutting, shredding and baling. We produce a number of differently sized, shaped and graded products depending upon customer specifications and market demand.

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

Cutting - Pieces of over-sized ferrous scrap material, such as obsolete steel girders and used pipe, which are too large for other processing, are cut with hand torches.

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

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

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

Non-Ferrous Operations

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

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

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

Throughout the sorting process, we determine whether the material requires further processing before we sell it.

Cutting - Pieces of over-sized non-ferrous scrap material, which are too large for other processing methods, are cut with hand torches.

Shredding - We shred large pieces of nonferrous scrap material, such as steel drums, copper and aluminum cable, tubing, sheet metal, extrusions, and baled aluminum, in our shredder by hammer mill action into pieces of a workable size that pass through magnetic separators to separate metal from synthetic foam, fabric, rubber, stone, dirt, etc. The

metal we recover from the shredding process we sell directly to customers or reuse in some other metal blend. We dispose of the

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non-metal components, which can reduce the volume of the scrap as much as 25.0%, in a landfill. We began using the shredder system July 1, 2009.

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

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

Waste Services Operations

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

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

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

“Total Package” Concept

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

Company Background

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

shares of ISA Common Stock. The existing directors resigned and five new directors were elected. On July 1, 1984, we began a solid waste handling and disposal equipment sales organization under the name Waste Equipment Sales and Services Company, which we refer to as WESSCO. On January 1, 1985, we merged with Computerized Waste Systems, Inc. ("CWS"), 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.

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

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

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

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

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

During 2007, we entered into an asset purchase agreement for \$1.3 million funded primarily by a note payable to Industrial Logistic Services, LLC, the sole member of which is Brian Donaghy, our president and chief operating officer, whereby we paid \$20.0 thousand per month for 60 months for various assets including tractor trailers, trucks and containers. The note payable reflected a seven percent (7.0%) interest payment on the outstanding balance plus principal amortization and was paid in full in August of 2012. We also paid ILS \$100.0 thousand cash as a portion of the purchase price at the time of execution of the asset purchase agreement.

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

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

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

In September of 2009, we purchased two tracts of real estate on Grade Lane near the current Grade Lane site through the acquisition of all outstanding membership interests in 7124 Grade Lane LLC and 7200 Grade Lane LLC, each a Kentucky limited liability company, owned by Harry Kletter Family Limited Partnership, a Kentucky limited

partnership. Mr. Kletter is our Vice-Chairman of the Board and Chief Executive Officer and the general partner of Harry Kletter Family Limited Partnership. One tract (7124 Grade Lane) contains the shredder, and the other tract (7200 Grade Lane) provides a new entrance for the shredder and ISA Alloys. We built new scales on this site, and ISA Alloys uses the space to store inventory. With respect to the purchase of the membership interests in 7200 Grade Lane LLC, we provided to the limited partnership 550,871 shares at \$4.27 per share for a purchase price of \$2.3 million and with respect to the purchase of the membership interests in 7124 Grade Lane LLC, we provided to the limited partnership 199,220 shares at \$4.27 per share for a purchase price of \$850.0 thousand.

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In November of 2009, we moved the ISA Alloys division from the Camp Ground Road location to 7100 Grade Lane. In July of 2010, we purchased certain Venture intangibles, including the customer list and trade name, and entered into a non-compete agreement to protect our market position.

On July 2, 2012, we opened the ISA Pick.Pull.Save used automobile yard, which is considered a new product line within the recycling segment.

Industry Background

The waste collection and disposal business in the United States is a multi-billion dollar industry. The size of this industry has increased for the past several years and should continue to increase as landfill space decreases. Although society and industry have developed an increased awareness of environmental issues and recycling has increased, waste production also continues to increase. Because of environmental concerns, new regulations and cost factors, it has become difficult to obtain the necessary permits to build any new landfills. We believe we are in a position to represent the best interest of our customers and find competitive pricing for their waste collection and disposal needs. In addition to increasing landfill costs, regulatory measures and more stringent control of material bound for disposal are making the management of solid waste an increasingly difficult problem. The United States Environmental Protection Agency ("EPA") is expected to continue the present trend of restricting the amount of potentially recyclable material bound for landfills. Many states have passed, or are contemplating, measures that would require industrial and commercial companies to recycle a minimum percentage of their waste stream and restrict the percentage of recyclable materials in any commercial load of waste material. Many states have already passed restrictive regulations requiring a plan for the reduction of waste or the segregation of recyclable materials from the waste stream at the source. ISA management believes that these restrictions may create additional marketing opportunities as waste disposal needs become more specialized. Some large industrial and commercial companies have hired in-house staff to handle the solid waste management and recycling responsibilities, but have found that without adequate resources and staff support, in-house handling of these responsibilities may not be an effective alternative. We offer these establishments a solution to this increasing burden.

Competition

The metal recycling business is highly competitive and is subject to significant changes in economic and market conditions. At the end of 2012, the American economy was improving in three important areas: employment, debt, and housing. In general, analysts reported signs of recovery from the recession that began in 2008, such as increased automobile and retail sales during the year, even considering the effects of several fourth quarter tragedies and uncertainties, such as Hurricane Sandy and the "fiscal cliff," health care costs. Although China's economy appears stable, in other areas of the world, such as Europe, countries are faced with necessary spending cuts, tax increases, and political uncertainties. Metal prices, specifically nickel, were volatile throughout the year, and ended the year slightly lower than they began, hitting lows in mid-August. Pricing and proximity to a metal source are the major competitive factors in the metal recycling business. We compete for the purchase and sale of scrap metal with large, well-financed recyclers of scrap metal as well as smaller metal facilities and brokers/dealers. Although we continue to expand our facilities and increase our processing efficiencies, including the completion of the shredder system in 2009, certain of our competitors have greater financial, marketing and physical resources. There can be no assurance that we will be able to obtain our desired market share based on the competitive nature of this industry.

On a commercial/industrial waste management level, we have competition from a variety of sources. Much of it is from companies that concentrate their efforts on a regional level and two of the major national waste haulers. We have faced increased competition from national hauling and recycling companies in recent years. The large national hauling and recycling companies often attempt to handle all locations for a "national chain" customer. This scenario poses a potential conflict of interest since these hauling companies and recyclers can attain greater profitability from increases in hauling and disposal revenues and fluctuations in recycling prices. In addition to having an economic incentive in allowing customers to have more hauls than needed, light loads, and higher hauling and disposal rates, the national hauling companies do not have operations in every community. Therefore, for many cities, hauling companies must obtain bids from local hauling, disposal and recycling companies that may perceive the national haulers to be competitors. We have encountered reluctance from independent hauling and recycling companies to support services in areas not serviced by these national companies. We have positioned ourselves to

work with the national and independent haulers and recyclers to efficiently service our customers on a nationwide basis.

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

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

Dependence on Major Customer

Sales to North American Stainless, our largest customer, represented approximately 41.2% and 44.4% of our net sales for the years ended December 31, 2012 and 2011, respectively. Our cash flow experiences a significant decline between the time we acquire scrap metal for processing and the time we receive payment for these goods. The loss of North American Stainless as a customer would negatively impact our revenues and profitability and could materially and adversely affect our results of operations and financial condition.

Employees

As of March 27, 2013, we had one hundred fifty-five (155) full-time employees as follows: recycling 84, management services 8, sales/leasing 2, drivers 16, maintenance 13, and administration/information technology 32. None of our employees are a member of a union.

Effect of State and Federal Environmental Regulations

Any environmental regulatory liability relating to our operations is generally borne by the customers with whom we contract and the service providers in their capacity as transporters, disposers and recyclers. Our policy is to use our best efforts to secure indemnification for environmental liability from our customers and service providers. Although we believe that our business model adequately protects us from potential environmental liability, we also continue to use our best efforts to be in compliance with federal, state and local environmental laws, including but not limited to the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, the Hazardous Materials Transportation Act, as amended, the Resource Conservation and Recovery Act, as amended, the Clean Air Act, as amended, and the Clean Water Act. Such compliance has not historically constituted a material expense to us. The collection and disposal of solid waste and rendering of related environmental services as well as recycling operations and issues are subject to federal, state and local requirements, which regulate health, safety, the environment, zoning and land-use. Federal, state and local regulations vary, but generally govern hauling, disposal and recycling activities and the location and use of facilities and also impose restrictions to prohibit or minimize air and water pollution. In addition, governmental authorities have the power to enforce compliance with these regulations and to obtain injunctions or impose fines in the case of violations, including criminal penalties. The EPA and various other federal, state and local environmental, health and safety agencies and authorities, including the Occupational Safety and Health Administration of the U.S. Department of Labor administer those regulations. We strive to conduct our operations in compliance with applicable laws and regulations. While such amounts expended in the past or that we anticipate spending in the future have not had and are not expected to have a material adverse effect on our financial condition or operations, the possibility remains that technological, regulatory or enforcement developments, the results of environmental studies or other factors could materially alter this expectation. Each state in which we operate has its own laws and regulations governing solid waste disposal, water and air pollution and, in most cases, releases and cleanup of hazardous substances and liability for such matters. Several states have enacted laws that will require counties to adopt comprehensive plans to reduce, through waste planning, composting, recycling, or other programs, the volume of solid waste landfills. Several states have recently enacted these laws. Legislative and regulatory measures to mandate or encourage waste reduction at the source and waste recycling also are under consideration by Congress and the EPA.

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

ITEM 1A. RISK FACTORS

Risk Factors

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

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

Risks Related to Our Operations

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

The metal recycling business is highly competitive and is subject to significant changes in economic and market conditions. At the end of 2012, the American economy was improving in three important areas: employment, debt, and housing. In general, analysts reported signs of recovery from the recession that began in 2008, such as increased automobile and retail sales during the year, even considering the effects of several fourth quarter tragedies and uncertainties, such as Hurricane Sandy and the "fiscal cliff," health care costs. Although China's economy appears stable, in other areas of the world, such as Europe, countries are faced with necessary spending cuts, tax increases, and political uncertainties. Metal prices, specifically nickel, were volatile throughout the year, and ended the year slightly lower than they began, hitting lows in mid-August. Pricing and proximity to a metal source are the major competitive factors in the metal recycling business. Many companies offer or are engaged in the development of products or the provisions of services that may be or are competitive with our current products or services. Although we continue to expand our facilities and increase our processing efficiencies, including the completion of the shredder system in 2009, certain of our competitors have greater financial, technical, manufacturing, marketing, distribution, and other resources and assets than we possess. In addition, the industry is constantly changing as a result of consolidation, which may create additional competitive pressures in our business environment. There can be no assurance that we will be able to obtain our desired market share based on the competitive nature of this industry.

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

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

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

Our operations are dependent upon fuel, which we generally purchase in the open market on a daily basis. Direct fuel costs include the cost of fuel and other petroleum-based products used to operate our shredder, fleet of cranes and heavy equipment. We are also susceptible to increases in indirect fuel costs which include fuel surcharges from vendors. When we have experienced increases in the cost of fuel and other petroleum-based products in the past, we were able to pass a portion of these increases 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. In 2012, the nationwide average price for one gallon of regular gasoline increased by ten cents as

compared to the nationwide average price for one gallon of regular gasoline in 2011 in part due to aging oil refineries that reduced their gasoline output. Although analysts forecast a decrease in the average price for gasoline in 2013 due to increased oil production in the United States and more fuel-efficient automobiles, there are numerous potential risks that could challenge this forecast, such as conflict in the Middle East that could affect crude oil prices, hurricanes and other severe weather conditions damaging refineries and reducing output, and political actions in Washington relating to the deficit that could weaken the dollar. A significant increase in fuel costs could adversely affect our business.

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

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

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

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

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

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

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

Sales to North American Stainless, our largest customer, represented approximately 41.2% and 44.4% of our net sales for the years ended December 31, 2012 and 2011, respectively. Our cash flow experiences a significant decline between the time we acquire scrap metal for processing and the time we receive payment for these goods. The loss of this or other significant customers or our inability to collect accounts receivable would negatively impact our revenues and profitability and could materially and adversely affect our results of operations and financial condition.

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

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

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

We are vulnerable to higher interest rates because interest expense on certain of our borrowings is based on margins over a variable base rate. We may experience material increases in our interest expense as a result of increases in general interest rate levels. If we were to breach covenants in our lending facilities, our lenders could exercise their remedies related to any material breaches, including acceleration of our payments and taking action with respect to their loan security. For the year ending December 31, 2012, we were not in compliance with two of our debt covenants under our primary credit facility with Fifth Third Bank. We received a waiver from the bank for failing to meet these requirements as of December 31, 2012. We cannot ensure that the bank would provide additional waivers if we are not in compliance with our debt covenants in the future.

From time to time, we have relied upon and will rely on borrowings under various credit facilities and from other lenders to operate our business. However, the recent financial crisis has adversely affected many financial institutions and, as a result, such financial institutions have ceased or reduced the amount of lending they have made available to their customers. As a result, we may not have the ability to borrow from other lenders to operate our business.

Seasonal changes may adversely affect our business and operations.

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

Risks Related to Our Common Stock

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

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

The market price for our common stock may be volatile.

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

- Our quarterly operating results or the operating results of our companies in the waste management or stainless steel, ferrous, non-ferrous and fiber recycling industry;

- Changes in general conditions in the economy, the financial markets or the stainless steel, ferrous, non-ferrous and fiber recycling industry;

- Loss of significant customers and

- Increases in materials and other costs.

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

Item 2.

Properties.

The following table outlines our principal properties:

Property Address	Lease or own	Segment	Acreage
6709 Grade Lane, Louisville, KY	Own	Recycling	4.491
7021-7103 Grade Lane, Louisville, KY	Own	Recycling	2.530
7020/7100 Grade Lane, Louisville, KY	Lease (K&R) (1)		