

**FORM 10-Q**

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

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

For the quarterly period ended June 30, 2006

OR

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

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-20979

INDUSTRIAL SERVICES OF AMERICA, INC.

(Exact Name of Registrant as specified in its Charter)

Florida

(State or other jurisdiction of  
Incorporation or Organization)

59-0712746

(IRS Employer  
Identification No.)

7100 Grade Lane, PO Box 32428

Louisville, Kentucky 40232

(Address of principal executive offices)

(502) 368-1661

(Registrant's Telephone Number, Including Area Code)

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of June 30, 2006: 3,620,899.

# INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

ITEM 1: CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	<u>June 30,</u> <u>2006</u> <u>(Unaudited)</u>	<u>December 31,</u> <u>2005</u>
Current assets		
Cash and cash equivalents	\$ 1,026,751	\$ 1,721,301
Accounts receivable - trade (after allowance for doubtful accounts of \$100,000 in 2006 and \$50,000 in 2005)	7,587,103	4,502,845
Net investment in sales-type leases	53,159	65,797
Inventories	3,089,910	2,488,609
Deferred income taxes	78,385	78,385
Other	<u>196,825</u>	<u>120,012</u>
Total current assets	12,032,133	8,976,949
Net property and equipment	7,581,522	7,604,712
Other Assets		
Goodwill	560,005	560,005
Net investment in sales-type leases	213,314	236,801
Notes receivable – related party	255,124	264,390
Other assets	<u>237,869</u>	<u>241,615</u>
	<u>1,266,312</u>	<u>1,302,811</u>
	<u>\$ 20,879,967</u>	<u>\$ 17,884,472</u>

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See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS  
CONTINUED

LIABILITIES AND STOCKHOLDERS' EQUITY

	<u>June 30,</u> <u>2006</u> <u>(Unaudited)</u>	<u>December 31,</u> <u>2005</u>
Current liabilities		
Current maturities of long term debt	\$ 144,428	\$ -
Current maturities of capital lease obligation	182,497	118,945
Accounts payable	6,718,757	8,282,281
Income tax payable	458,113	109,129
Other current liabilities	<u>444,659</u>	<u>1,357,903</u>
Total current liabilities	7,948,454	9,868,258
Long-term liabilities		
Long-term debt	3,855,572	-
Capital lease obligation	146,071	152,889
Deferred income taxes	<u>413,570</u>	<u>413,570</u>
	4,415,213	566,459
Stockholders' equity		
Common stock, \$.005 par value, 10,000,000 shares authorized, 4,315,000 and 4,255,000 shares issued in 2006 and 2005, 3,620,899 and 3,566,408 shares outstanding in 2006 and 2005	21,575	21,275
Additional paid-in capital	3,177,119	3,113,819
Retained earnings	6,065,694	5,046,411
Treasury stock, 694,101 and 688,592 shares at average cost in 2006 and 2005	<u>(748,088)</u>	<u>(731,750)</u>
	<u>8,516,300</u>	<u>7,449,755</u>
	<u>\$ 20,879,967</u>	<u>\$ 17,884,472</u>

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See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
THREE MONTHS ENDED JUNE 30, 2006 AND 2005  
(UNAUDITED)

	<u>2006</u>	<u>2005</u>
Revenue from services	\$ 3,768,974	\$ 25,540,127
Revenue from product sales	<u>13,933,660</u>	<u>7,859,780</u>
<b>Total Revenue</b>	17,702,634	33,399,907
Cost of goods sold for services	3,372,132	24,612,402
Cost of goods sold for product sales	<u>11,872,693</u>	<u>6,952,846</u>
<b>Total Cost of goods sold</b>	15,244,825	31,565,248
Selling, general and administrative expense	<u>1,450,284</u>	<u>1,481,772</u>
<b>Income before other income (expense)</b>	1,007,525	352,887
Other income (expense)		
Interest expense	(69,584)	(26,263)
Interest income	36,354	21,059
Gain/loss on sale of assets	27,207	(2,614)
Other income	<u>3,092</u>	<u>7,691</u>
	<u>(2,931)</u>	<u>(127)</u>
<b>Income before income taxes</b>	1,004,594	352,760
Income tax provision	<u>401,837</u>	<u>141,081</u>
<b>Net income</b>	<u>\$ 602,757</u>	<u>\$ 211,679</u>
Basic earnings per share	<u>\$ 0.17</u>	<u>\$ 0.06</u>
Diluted earnings per share	<u>\$ 0.17</u>	<u>\$ 0.06</u>
Weighted shares outstanding:		
Basic	<u>3,574,306</u>	<u>3,576,408</u>
Diluted	<u>3,590,214</u>	<u>3,591,054</u>

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See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
SIX MONTHS ENDED JUNE 30, 2006 AND 2005  
(UNAUDITED)

	<u>2006</u>	<u>2005</u>
Revenue from services	\$ 7,713,893	\$ 46,861,129
Revenue from product sales	<u>24,472,761</u>	<u>16,213,248</u>
<b>Total Revenue</b>	32,186,654	63,074,377
Cost of goods sold for services	6,871,613	44,977,368
Cost of goods sold for product sales	<u>20,818,686</u>	<u>14,510,867</u>
<b>Total Cost of goods sold</b>	27,690,299	59,488,235
Selling, general and administrative expense	<u>2,800,137</u>	<u>2,975,645</u>
<b>Income before other income (expense)</b>	1,696,218	610,497
Other income (expense)		
Interest expense	(96,969)	(50,474)
Interest income	64,576	45,564
Gain/loss on sale of assets	24,926	(11,575)
Other income	<u>10,054</u>	<u>7,230</u>
	<u>2,587</u>	<u>(9,255)</u>
<b>Income before income taxes</b>	1,698,805	601,242
Income tax provision	<u>679,522</u>	<u>240,475</u>
<b>Net income</b>	<u>\$ 1,019,283</u>	<u>\$ 360,767</u>
Basic earnings per share	<u>\$ 0.29</u>	<u>\$ 0.10</u>
Diluted earnings per share	<u>\$ 0.29</u>	<u>\$ 0.10</u>
Weighted shares outstanding:		
Basic	<u>3,567,639</u>	<u>3,576,351</u>
Diluted	<u>3,582,308</u>	<u>3,599,957</u>

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See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC.  
AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
SIX MONTHS ENDED JUNE 30, 2006  
(UNAUDITED)

	<u>Common Stock</u>		<u>Additional</u>	<u>Retained</u>	<u>Treasury Stock</u>		<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u> <u>Capital</u>	<u>Earnings</u>	<u>Shares</u>	<u>Cost</u>	
<b>Balance as of December 31, 2005</b>	4,255,000	\$21,275	\$3,113,819	\$5,046,411	(688,592)	\$ (731,750)	\$7,449,755
Treasury stock purchase	-	-	-	-	(5,509)	(16,338)	(16,338)
Issuance of Common stock in connection with exercise of stock options	60,000	300	63,300	-	-	-	63,600
Net income	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,019,283</u>	<u>-</u>	<u>-</u>	<u>1,019,283</u>
<b>Balance as of June 30, 2006</b>	<u>4,315,000</u>	<u>\$21,575</u>	<u>\$3,177,119</u>	<u>\$6,065,694</u>	<u>(694,101)</u>	<u>\$ (748,088)</u>	<u>\$8,516,300</u>

See accompanying notes to consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
SIX MONTHS ENDED JUNE 30, 2006 AND 2005  
(UNAUDITED)

	<u>2006</u>	<u>2005</u>
<b>Cash flows from operating activities</b>		
Net income	\$ 1,019,283	\$ 360,767
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	862,833	852,687
Treasury stock distribution to employees	-	6,524
(Gain)/loss on sale of property and equipment	(24,926)	11,575
Change in assets and liabilities		
Receivables	(3,084,258)	(1,038,673)
Net investment in sales-type leases	36,125	41,361
Inventories	(601,301)	(794,070)
Other assets	(73,067)	66,502
Accounts payable	(1,563,524)	1,926,088
Other current liabilities	<u>(564,260)</u>	<u>10,253</u>
Net cash from operating activities	(3,993,095)	1,443,014
<b>Cash flows from investing activities</b>		
Proceeds from sale of property and equipment	33,100	63,982
Purchases of property and equipment	(727,421)	(1,107,029)
Payments from related party	<u>9,266</u>	<u>-</u>
Net cash from investing activities	(685,055)	(1,043,047)
<b>Cash flows from financing activities</b>		
Purchases of common stock	(16,338)	-
Issuance of common stock	63,600	-
Payments on capital lease obligation	(63,662)	(482,034)
Proceeds from long-term debt	<u>4,000,000</u>	<u>-</u>
Net cash from financing activities	<u>3,983,600</u>	<u>(482,034)</u>
Net decrease in cash	(694,550)	(82,067)
Cash at beginning of period	<u>1,721,301</u>	<u>1,129,690</u>
<b>Cash at end of period</b>	<b><u>\$ 1,026,751</u></b>	<b><u>\$ 1,047,623</u></b>
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 96,969	\$ 50,474
Cash paid for taxes	330,539	40,310
Supplemental disclosure of noncash investing and financing activities:		
Equipment purchased under capital leases	120,395	-

See accompanying notes to consolidated financial statements.

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

(Unaudited)

**NOTE 1 – BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U. S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U. S. generally accepted accounting principles for complete consolidated financial statements. The information furnished includes all adjustments, which are, in the opinion of management, necessary to present fairly our financial position as of June 30, 2006 and the results of our operations and changes in our cash flow for the periods ended June 30, 2006 and 2005. Results of operations for the period ended June 30, 2006 are not necessarily indicative of the results that may be expected for the entire year. Additional information, including the audited December 31, 2005 consolidated financial statements and the Summary of Significant Accounting Policies, is included in our Annual Report on Form 10-K for the year ended December 31, 2005 on file with the Securities and Exchange Commission.

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.

**NOTE 2 – ESTIMATES**

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

**NOTE 3 – LONG TERM DEBT AND NOTES PAYABLE TO BANK**

We currently maintain a \$5.0 million senior revolving credit facility with the Branch Banking and Trust Company. Indebtedness under this credit facility accrues interest at BB&T's prime rate less one-eighth, 7.875% as of June 30, 2006. The maturity date under this agreement is January 2008. We have collateralized the credit facility with all our assets. As of June 30, 2006 we had borrowed \$2,000,000 and as of December 31, 2005, there were no borrowings against the credit facility. The terms of the credit facility 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 June 30, 2006, we were in compliance with all restrictive covenants and the entire amount of our credit facility (less our outstanding borrowings) was available for borrowings.

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 June 30, 2006 we had borrowed \$2,000,000 and as of December 31, 2005, there were no borrowings 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 June 30, 2006, we were in compliance with all restrictive covenants.

#### **NOTE 4 – 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.

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.

<b>FOR THE SIX MONTHS ENDED JUNE 30, 2006</b>	<b>ISA RECYCLING</b>	<b>COMPUTERIZED WASTE SYSTEMS</b>	<b>WASTE EQUIPMENT SALES &amp; SERVICES</b>	<b>OTHER</b>	<b>SEGMENT TOTALS</b>
Recycling revenues	\$ 23,566,384	\$ -	\$ -	\$ -	\$ 23,566,384
Equipment sales, service and leasing revenues	-	-	906,377	-	906,377
Management fees	-	7,713,893	-	-	7,713,893
Cost of goods sold	(20,382,864)	(6,871,613)	(435,822)	-	(27,690,299)
Selling, general and administrative expenses	<u>(654,021)</u>	<u>(768,579)</u>	<u>(300,721)</u>	<u>(1,076,816)</u>	<u>(2,800,137)</u>
Segment profit (loss)	<u>\$ 2,529,499</u>	<u>\$ 73,701</u>	<u>\$ 169,834</u>	<u>\$ (1,076,816)</u>	<u>\$ 1,696,218</u>
Segment assets	<u>\$ 13,148,841</u>	<u>\$ 1,925,529</u>	<u>\$ 2,089,022</u>	<u>\$ 3,716,575</u>	<u>\$20,879,967</u>

<b>FOR THE SIX MONTHS ENDED JUNE 30, 2005</b>	<b>ISA RECYCLING</b>	<b>COMPUTERIZED WASTE SYSTEMS</b>	<b>WASTE EQUIPMENT SALES &amp; SERVICES</b>	<b>OTHER</b>	<b>SEGMENT TOTALS</b>
Recycling revenues	\$ 14,780,866	\$ -	\$ -	\$ -	\$ 14,780,866
Equipment sales, service and leasing revenues	-	-	1,432,382	-	1,432,382
Management fees	-	46,861,129	-	-	46,861,129
Cost of goods sold	(13,607,793)	(44,977,368)	(903,074)	-	(59,488,235)
Selling, general and administrative expenses	<u>(467,947)</u>	<u>(923,445)</u>	<u>(339,093)</u>	<u>(1,245,160)</u>	<u>(2,975,645)</u>
Segment profit (loss)	<u>\$ 705,126</u>	<u>\$ 960,316</u>	<u>\$ 190,215</u>	<u>\$(1,245,160)</u>	<u>\$ 610,497</u>
Segment assets	<u>\$ 9,664,291</u>	<u>\$ 7,726,605</u>	<u>\$ 2,213,062</u>	<u>\$ 3,297,051</u>	<u>\$22,901,009</u>

#### **NOTE 5 – INVENTORIES**

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

Some commodities are in saleable condition at acquisition. We purchase these commodities in small amounts until we have a truckload of material available for shipment. Some commodities are not in saleable condition at acquisition. These commodities must be torched, sheared or baled. We do not have work-in-process inventory that needs to be manufactured to become finished goods. We include processing costs in inventory for all commodities. Ferrous inventory of \$1,630,424 at June 30, 2006 was comprised of \$527,224 in raw materials and \$1,103,200 of finished goods. Non-ferrous inventory of \$1,397,075 at June 30, 2006 was comprised of \$380,239 in raw materials and \$1,016,836 of finished goods. Ferrous inventory of \$1,380,050 at December 31, 2005 was comprised of \$402,041 in raw materials and \$978,009 of finished goods. Non-ferrous inventory of \$961,085 at December 31, 2005 was comprised of \$196,508 in raw materials and \$764,577 of finished goods. We charged \$1,111,306 in general and administrative processing costs to cost of sales for the six months ended June 30, 2006 and \$2,015,733 for the year ended December 31, 2005.

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 June 30, 2006 and December 31, 2005 consist of the following:

	<b>June 30, <u>2006</u></b>	<b>December 31, <u>2005</u></b>
Ferrous	\$ 1,630,424	\$ 1,380,050
Non-ferrous	1,397,075	961,085
Waste equipment machinery	31,108	120,922
Other	<u>31,303</u>	<u>26,552</u>
Total inventories	<u>\$ 3,089,910</u>	<u>\$ 2,488,609</u>

## NOTE 6 – PER SHARE DATA

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

Six months ended June 30, 2006 compared to six months ended June 30, 2005:

	<u>2006</u>	<u>2005</u>
<b>Basic earnings per share</b>		
Net income	\$ 1,019,283	\$ 360,767
Weighted average shares outstanding	<u>3,567,639</u>	<u>3,576,351</u>
Basic earnings per share	<u>\$ .29</u>	<u>\$ .10</u>
<b>Diluted earnings per share</b>		
Net income	\$ 1,019,283	\$ 360,767
Weighted average shares outstanding	3,567,639	3,576,351
Add dilutive effect of assumed exercising of stock options	<u>14,669</u>	<u>23,606</u>
Diluted weighted average shares outstanding	<u>3,582,308</u>	<u>3,599,957</u>
Diluted earnings per share	<u>\$ .29</u>	<u>\$ .10</u>

Three months ended June 30, 2006 compared to three months ended June 30, 2005:

	<u>2006</u>	<u>2005</u>
<b>Basic earnings per share</b>		
Net income	\$ 602,757	\$ 211,679
Weighted average shares outstanding	<u>3,574,306</u>	<u>3,576,408</u>
Basic earnings per share	<u>\$ .17</u>	<u>\$ .06</u>
<b>Diluted earnings per share</b>		
Net income	\$ 602,757	\$ 211,679
Weighted average shares outstanding	3,574,306	3,576,408
Add dilutive effect of assumed exercising of stock options	<u>15,908</u>	<u>14,646</u>
Diluted weighted average shares outstanding	<u>3,590,214</u>	<u>3,591,054</u>
Diluted earnings per share	<u>\$ .17</u>	<u>\$ .06</u>

## **NOTE 7 – LITIGATION SETTLEMENT**

Effective as of May 5, 2006, we entered into an agreement with Andrew M. Lassak to settle Mr. Lassak's claims against us in *Lassak v. Industrial Services of America, Inc., et al*, No. 04-423-CA (Fla. 19th Cir. Ct. filed June 2, 2004). Lassak's demands and claims included rights to purchase 240,500 shares of our common stock for \$1.25 per share, rights to purchase 149,500 shares of our common stock for \$3.00 per share, and demand and piggyback registration rights as well as cashless exercise rights with respect to such options. Since the inception of the suit, we have disputed Lassak's claims and have denied any liability for Lassak's claims and demands. Pursuant to the settlement agreement, we allowed Lassak to exercise a reduced number of the options he was seeking – 40,000 at an exercise price of \$1.25 per share. Lassak tendered to us the full exercise price for the 40,000 options and we filed a registration statement for the underlying shares with the Securities and Exchange Commission on May 24, 2006. The registration was declared effective by the Securities and Exchange Commission on June 12, 2006. We then delivered 40,000 registered shares to Lassak, thereby satisfying all our requirements under the settlement agreement and effectively concluding this matter. The estimated fair value of these options is approximately \$270,000.

## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

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

*The following discussion and analysis contains certain financial predictions, forecasts and projections which constitute "forward-looking statements" within the meaning of the federal securities laws. Actual results could differ materially from those financial predictions, forecasts and projections and there can be no assurance that we will achieve such financial predictions, forecasts and projections. Factors that could affect financial predictions, forecasts and projections include the fluctuations in the commodity price index and any conditions internal to our major customers, including loss of their accounts and other factors as listed in our Form 10-K for the year ended December 31, 2005, as filed with the Securities and Exchange Commission.*

### **General**

Much of our focus and attention now and in the future is directed 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 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 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 have operating locations in Louisville and Lexington, Kentucky and Seymour, Indiana. We do not have operating locations outside the United States but we service 1,721 customer locations throughout the United States and Canada, building a base of approximately 965 service providers. We have no revenue or cost of goods sold derived from customers located outside the United States or Canada. We do not separate selling, general and administrative expenses between customers located in the United States or outside the United States.

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.

### **Liquidity and Capital Resources**

As of June 30, 2006 we held cash and cash equivalents of \$1,026,751.

We currently maintain a \$5.0 million senior revolving credit facility with the Branch Banking and Trust Company. Indebtedness under this credit facility accrues interest at BB&T's prime rate less one-eighth, 7.875% as of June 30, 2006. The maturity date under

this agreement is January 2008. We have collateralized the credit facility with all our assets except our rental fleet. As of June 30, 2006 we had borrowed \$2,000,000 and as of December 31, 2005, there were no borrowings against the credit facility. The terms of the credit facility 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 June 30, 2006, we were in compliance with all restrictive covenants and the entire amount of our credit facility (less the outstanding borrowings) was available for borrowings.

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 June 30, 2006 we had borrowed \$2,000,000 and as of December 31, 2005, there were no borrowings 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 June 30, 2006, we were in compliance with all restrictive covenants.

During the first two quarters of 2006, we purchased \$847,817 of property and equipment. In the recycling segment we spent \$523,579 for an automobile crusher, a forklift, a loader, open top containers, crane improvements, and upgrades to our radiation detection system. In the equipment sales, leasing and service segment, we purchased \$311,864 in rental equipment that we located at customer sites. This rental fleet equipment consists of solid waste handling and recycling equipment such as compactors, containers and balers. It is our intention to continue to pursue this market. We purchased office equipment of \$5,555 and spent \$6,819 on buildings.

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 June 30, 2006 was \$776,570 with a due date of July 15, 2006. The card accrues interest at prime plus 5.9% after the first twenty-five days of the purchase; our intention is to pay off the full balance every month so as to not incur finance charges. To date we have not incurred any interest charges on this purchasing card. The card requires monthly minimum payments on any balance outstanding at month end. We receive rebates on an annual basis for all purchases made with the card.

We expect that existing cash flow from operations and available credit under our existing credit facilities will be sufficient to meet our cash needs during the remainder of 2006.

## Results of Operations

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

	<u>Six months ended June 30,</u>	
	<u>2006</u>	<u>2005</u>
Statements of Operations Data:		
Total Revenue .....	100.0%	100.0%
Cost of goods sold.....	86.0%	94.3%
Selling, general and administrative expenses .....	8.7%	4.7%
Income before other expenses.....	5.3%	1.0%

### Six months ended June 30, 2006 compared to six months ended June 30, 2005

Total revenue decreased \$30,887,723 or 49.0% to \$32,186,654 in 2006 compared to \$63,074,377 in 2005. Recycling revenue increased \$8,785,518 or 59.4% to \$23,566,384 in 2006 compared to \$14,780,866 in 2005. This is primarily due to an increase of 27% in the volume of shipments and a 31% increase in price of commodities in the recycling market. Management services revenue decreased \$39,147,236 or 83.5% to \$7,713,893 in 2006 compared to \$46,861,129 in 2005. This change is due to the loss of Home Depot as a customer. Equipment, service and leasing revenue decreased \$526,005 or 36.7% to \$906,377 in 2006 compared to \$1,432,382 in 2005. This decrease is due to a decrease in rental revenue.

Total cost of goods sold decreased \$31,797,936 or 53.5% to \$27,690,299 in 2006 compared to \$59,488,235 in 2005. Recycling cost of goods sold increased \$6,775,071 or 49.4% to \$20,382,864 in 2006 compared to \$13,607,793 in 2005. This is due to an increase of 8% in the volume of purchases and 52% higher commodity purchase prices in the recycling market. Management services cost of goods sold decreased \$38,105,755 or 84.7% to \$6,871,613 in 2006 compared to \$44,977,368 in 2005 due to the loss of Home Depot as a customer. Equipment, service and leasing cost of goods sold decreased \$467,252 or 51.7% to \$435,822 in 2006 compared to \$903,074 in 2005. The decrease is due to a decrease in equipment costs.

Selling, general and administrative expenses decreased \$175,508 or 5.9% to \$2,800,137 in 2006 compared to \$2,975,645 in 2005. As a percentage of revenue, selling, general and administrative expenses were 8.7% in 2006 compared to 4.7% in 2006. The percentage of revenue increase is due to lower revenue in the first two quarters of 2006. The primary driver of the decrease in total expenses is labor and related benefits, which decreased \$171,000 due to cutbacks in service and clerical labor, sales managers, supervisors, and group insurance savings.

Other income (expense) increased \$11,842 to other income of \$2,587 in 2006 compared to other expense of (\$9,255) in 2005. This was primarily due to an increase in gain on disposal of assets of \$32,300 and an increase in interest income of \$19,000, offset by an increase in interest expense of \$46,500.

### Three months ended June 30, 2006 compared to three months ended June 30, 2005

Total revenue decreased \$15,697,273 or 47.0% to \$17,702,634 in 2006 compared to \$33,399,907 in 2005. Recycling revenue increased \$6,364,906 or 89.7% to \$13,463,085 in 2006 compared to \$7,098,179 in 2005. This is primarily due to an increase of 27% in the volume of shipments and a 48% increase in price of commodities in the recycling market. Management services revenue decreased \$21,771,153 or 85.2% to \$3,768,974 in 2006 compared to \$25,540,127 in 2005. This change is due to the loss of Home Depot as a customer. Equipment, service and leasing revenue decreased \$291,026 or 38.2% to \$470,575 in 2006 compared to \$761,601 in 2005. This decrease is due to a decrease in rental revenue.

Total cost of goods sold decreased \$16,320,423 or 51.7% to \$15,244,825 in 2006 compared to \$31,565,248 in 2005. Recycling cost of goods sold increased \$5,214,141 or 80.9% to 11,660,202 in 2006 compared to \$6,446,061 in 2005. This is due to an increase of 13% in the volume of purchases and 77% higher commodity purchase prices in the recycling market. Management services cost of goods sold decreased \$21,240,270 or 86.38% to \$3,372,132 in 2006 compared to \$24,612,401 in 2005 due to the loss of Home Depot as a customer. Equipment, service and leasing cost of goods sold decreased \$294,296 or 58.1% to \$212,490 in 2006 compared to \$506,786 in 2005. The decrease is due to a decrease in equipment costs.

Selling, general and administrative expenses decreased \$31,488 or 2.1% to \$1,450,284 in 2006 compared to \$1,481,772 in 2005. As a percentage of revenue, selling, general and administrative expenses were 8.2% in 2006 compared to 4.4% in 2005. The percentage of revenue increase is due to lower revenue in the first two quarters of 2006. The primary driver of the decrease in total expenses is labor and related benefits, which decreased \$74,000 due to cutbacks in service and clerical labor, sales managers, supervisors, and group insurance savings.

Other expense increased \$2,804 to \$2,931 in 2006 compared to other expense of \$127 in 2005. This was primarily due to an increase in interest expense offset by increases in interest income and gain on sale of assets.

### Financial condition at June 30, 2006 compared to December 31, 2005

Cash and cash equivalents decreased \$694,550 to \$1,026,751 as of June 30, 2006 compared to \$1,721,301 as of December 31, 2005.

We used net cash from operating activities of \$3,993,095 for the six months ended June 30, 2006. Primarily this was due to an increase in accounts receivable of \$3,084,258 and a decrease of \$1,563,524 in accounts payable in the first two quarters of 2006.

We used net cash from investing activities of \$685,055 for the six months ended June 30, 2006. Primarily, we purchased recycling and rental fleet equipment of \$847,817. The rental fleet equipment consists of solid waste handling and recycling equipment such as compactors, containers and balers. It is our intention to continue to pursue this market.

Our net cash from financing activities of \$3,983,600 for the six months ended June 30, 2006 is primarily due to the advance of \$4,000,000 on both our line of credit and our new rental fleet loan, offset by purchases of treasury stock.

Accounts receivable trade increased \$3,084,258 or 68.5% to \$7,587,103 as of June 30, 2006 compared to \$4,502,845 as of December 31, 2005. This change is primarily due to an increase in

the volume of shipments and an increase in the selling prices in the Recycling segment.

Inventories consist principally of ferrous and nonferrous scrap materials and waste equipment machinery held for resale. We value inventory at the lower of cost or market. Inventory increased \$601,301 or 24% to \$3,089,910 as of June 30, 2006 compared to \$2,488,609 as of December 31, 2005.

Inventory aging for the period ended June 30, 2006 (Days Outstanding):

Description	1-30	31-60	61-90	Over 90	Total
Equipment & parts	\$ -	\$ -	\$ -	\$ 31,108	\$ 31,108
Ferrous materials	893,469	454,778	67,612	214,565	1,630,424
Non-ferrous materials	1,164,239	105,403	50,600	76,833	1,397,075
Other	<u>31,303</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>31,303</u>
	\$2,089,011	\$ 560,181	\$ 118,212	\$ 322,506	\$3,089,910

Inventory aging for the year ended December 31, 2005 (Days Outstanding):

Description	1-30	31-60	61-90	Over 90	Total
Equipment & parts	\$ 29,437	\$ 22,400	\$ -	\$69,085	\$ 120,922
Ferrous Materials	731,924	353,962	182,650	111,514	1,380,050
Non-ferrous materials	737,190	108,394	53,300	62,201	961,085
Other	<u>26,552</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>26,552</u>
	\$1,525,103	\$ 484,756	\$ 235,950	\$242,800	\$ 2,488,609

Accounts payable trade decreased \$1,563,524 or 18.9% to \$6,718,757 as of June 30, 2006 compared to \$8,282,281 as of December 31, 2005, primarily due to market conditions.

Working capital increased \$4,974,988 to \$4,083,679 as of June 30, 2006 compared to a deficit of \$891,309 as of December 31, 2005. The increase was primarily driven by the \$3.1 million increase in accounts receivable and the \$1.6 million decrease in accounts payable.

## Contractual Obligations

The following table provides information with respect to our known contractual obligations for the quarter ended June 30, 2006.

Obligation Description	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt Obligations (1)	\$4,000,000	\$144,428	\$2,320,110	\$1,535,462	\$0
Capital Lease Obligations (2)	328,568	182,496	146,072	0	0
Operating Lease Obligations (3)	1,061,460	634,798	409,323	17,339	0
Total	\$5,390,027	\$ 961,722	\$2,875,504	\$1,552,801	\$0

- (1) We currently maintain a \$5.0 million senior revolving credit facility with the Branch Banking and Trust Company. Indebtedness under this credit facility accrues interest at BB&T's prime rate less one eighth. The maturity date under this agreement is January 2008. We have collateralized the credit facility with all our assets except our rental fleet.

We also have a \$2.0 million loan agreement with Fifth Third Bank. Indebtedness under this loan agreement accrues interest at a fixed interest rate of 6.83%. The maturity date is June 2011 with a ten-year amortization schedule and is collateralized by our rental fleet equipment.

- (2) We lease various pieces of equipment that qualify for capital lease treatment. These lease arrangements require monthly lease payments expiring at various dates through May 2008.

(3) We lease the Louisville, Kentucky facility from K&R, LLC, the sole member of which is Harry Kletter, our chief executive officer, under an operating lease expiring December 2007. We have monthly rental payments of \$42,106 through December 2007. In the event of a change of control, the monthly payments become \$62,500. We also lease a management services operations facility and various pieces of equipment in Dallas, Texas for which monthly payments of \$2,525 are due through September 2007. We also lease security equipment for which monthly payments of \$464 are due through July 2009. We also lease property in Lexington, Kentucky for which monthly payments of \$2,250 are due through February 2010.

## Impact of Recently Issued Accounting Standards

SFAS No. 154, *Accounting Changes and Error Corrections*, replaces APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change.

### ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Fluctuating commodity prices affect market risk in our recycling segment. We mitigate this risk by selling our product on a monthly contract basis. Each month we negotiate selling prices for all commodities. Based on these monthly agreements, we determine purchase prices based on a margin needed to cover processing and administrative expenses.

We are exposed to interest rate risk on our floating rate borrowings. As of June 30, 2006, variable rate borrowings consisted of outstanding borrowings of \$2.0 million under our credit agreement. Borrowings on our credit agreement bear interest at the prime rate less 1/8. Any increase in prime rate would lead to higher interest expense. We do not have any interest rate swaps or caps in place, which would mitigate our exposure to fluctuations in the interest rate on this indebtedness. Based on our average anticipated borrowings under our credit agreement in fiscal 2006, a hypothetical increase or decrease in the prime rate by 1% would increase or decrease interest expense on our variable borrowings by approximately \$20,000 per year, with a corresponding change in cash flows.

### ITEM 4: CONTROLS AND PROCEDURES

#### (a) Evaluation of disclosure controls and procedures.

Based on the evaluation of the ISA Chief Executive Officer and the ISA Chief Financial Officer of our disclosure controls and procedures as of June 30, 2006, it has been concluded that the disclosure controls and procedures are effective for the purposes contemplated by Rules 13a-15(e) and 15d – 15(e) promulgated by the Securities and Exchange Commission.

#### (b) Changes in internal controls over financial reporting.

There have been no significant changes to ISA's internal controls or in other factors that have materially affected, or are reasonably likely to materially affect, these controls over financial reporting subsequent to June 30, 2006.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

Effective as of May 5, 2006, we entered into an agreement with Andrew M. Lassak to settle Mr. Lassak's claims against us in Lassak v. Industrial Services of America, Inc., et al, No. 04-423-CA (Fla. 19th Cir. Ct. filed June 2, 2004). Lassak's demands and claims included rights to purchase 240,500 shares of our common stock for \$1.25 per share, rights to purchase 149,500 shares of our common stock for \$3.00 per share, and demand and piggyback registration rights as well as cashless exercise rights with respect to such options. Since the inception of the suit, we have disputed Lassak's claims and have denied any liability for Lassak's claims and demands. Pursuant to the settlement agreement, we allowed Lassak to exercise a reduced number of the options he was seeking – 40,000 at an exercise price of \$1.25 per share. Lassak tendered to us the full exercise price for the 40,000 options and we filed a registration statement for the underlying shares with the Securities and Exchange Commission on May 24, 2006. The registration was declared effective by the Securities and Exchange Commission on June 12, 2006. We then delivered 40,000 registered shares to Lassak, thereby satisfying all our requirements under the settlement agreement and effectively concluding this matter.

### Item 1A. Risk Factors

We have had no material changes from the risk factors reported in our Form 10-K for the year ended December 31, 2005, as filed with the Securities and Exchange Commission on March 20, 2006.

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

(c) On November 15, 2005, our Board of Directors authorized a new program to repurchase up to 200,000 shares of our common stock at current market prices. During 2006, we have repurchased 5,509 shares. 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
Jan-06	5,509	\$ 2.9658	5,509	184,491
Feb-06	-			
Mar-06	-			

Apr-06 -  
 May-06 -  
 June-06 -

Item 3. Defaults upon Senior Securities  
 None

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

- (a) At the Annual Meeting of Shareholders held on June 6, 2006, the following proposals were adopted by the margins indicated:
- (b) PROPOSAL 1: Annual Election of Directors. The nominees for election as directors were Harry Kletter, Roman Epelbaum, David W. Lester, Orson Oliver, Albert Cozzi, Craig Feltner and Richard Ferguson. The seven director positions were filled based upon the seven receiving the most votes:

	<u>For</u>	<u>Withheld</u>	<u>Broker Non-Votes And Abstentions</u>
Harry Kletter	2,973,862	14,521	-
Roman Epelbaum	2,974,562	13,821	-
Albert A. Cozzi	2,974,562	13,821	-
David W. Lester	2,974,562	13,821	-
Richard E. Ferguson	2,974,562	13,821	-
Orson Oliver	2,974,562	13,821	-
Craig A. Feltner	2,367,012	621,371	-

- (c) PROPOSAL 2: Ratification of Mountjoy & Bressler, LLP as our independent auditors.

<u>For</u>	<u>Against</u>	<u>Broker Non Votes And Abstentions</u>
2,953,176	16,407	18,800

Item 5. Other Information

None

Item 6. Exhibits

See exhibit index

## SIGNATURES

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

INDUSTRIAL SERVICES OF AMERICA, INC.

Date: August 14, 2006

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

Date: August 14, 2006

/s/ Alan L. Schroering  
Chief Financial Officer

## INDEX TO EXHIBITS

**Exhibit  
Number**

**Description of Exhibits**

- |      |   |
|------|---|
| 31.1 | Rule 13a-14(a) Certification of Harry Kletter for the Form 10-Q for the quarter ended June 30, 2006.                  |
| 31.2 | Rule 13a-14(a) Certification of Alan Schroering for the Form 10-Q for the quarter ended June 30, 2006.                |
| 32.1 | Section 1350 Certification of Harry Kletter and Alan Schroering for the Form 10-Q for the quarter ended June 30, 2006 |

CERTIFICATIONS

I, Harry Kletter, being the Chief Executive Officer, certify that:

1. I have reviewed the Form 10-Q for the quarter ended June 30, 2006 of Industrial Services of America, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

- a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) not applicable
- c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- d) disclosed in the report any change in the registrant's internal control over financial reporting that occurred during the registrant's first quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

- a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 14, 2006  
Date

/s/ Harry Kletter  
Harry Kletter, Chief Executive Officer

CERTIFICATIONS

I, Alan Schroering, being the Chief Financial Officer, certify that:

1. I have reviewed the Form 10-Q for the quarter ended June 30, 2006 of Industrial Services of America, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

- a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) not applicable
- c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- d) disclosed in the report any change in the registrant's internal control over financial reporting that occurred during the registrant's first quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 14, 2006

Date

/s/ Alan Schroering

Alan Schroering, Chief Financial Officer

CERTIFICATIONS

Harry Kletter and Alan L. Schroering, being the Chief Executive Officer and Chief Financial Officer, respectively, of Industrial Services of America, Inc., hereby certify as of this 14th day of August, 2006, that the Form 10-Q for the Quarter ended June 30, 2006, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Industrial Services of America, Inc.

/s/ Harry Kletter  
Harry Kletter, Chief Executive Officer

/s/ Alan L. Schroering  
Alan L. Schroering, Chief Financial Officer