INDUSTRIAL SERVICES OF AMERICA INC
Form 10-Q
August 08, 2018

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xbrli:shares xbrli:pure utr:acre utr:M iso4217:USD iso4217:USD xbrli:shares idsa:director idsa:roof idsa:item

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, 2018

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

Louisville, Kentucky 40213

(Address of principal executive offices)

(502) 366-3452

(Registrant's Telephone Number, Including Area Code)

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 issued and outstanding of each of the issuer’s classes of common stock, as of August 6, 2018: 8,107,865.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

ITEM 1: CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	June 30, 2018 **(Unaudited)**	**December 31, 2017**
	(in thousands)	
Current assets		
Cash and cash equivalents	$ 691	$ 841
Accounts receivable – trade after allowance for doubtful accounts of $60.0 thousand in 2018 and 2017	6,262	4,220
Receivables and other assets from related parties (Note 6)	48	92
Inventories (Note 2)	7,989	5,106
Prepaid expenses and other current assets	355	182
Total current assets	15,345	10,441
Net property and equipment	10,397	11,212
Other assets		
Deferred income taxes	27	27
Other non-current assets	240	187
Total other assets	267	214
Total assets	$ 26,009	$ 21,867

See accompanying notes to condensed consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

CONTINUED

LIABILITIES AND SHAREHOLDERS' EQUITY

	June 30, 2018 (Unaudited)	December 31, 2017
	(in thousands, except par value and share informatio	
Current liabilities		
Current maturities of long-term debt (Note 3)	$ 6,924	$ 5,018
Current maturities of long-term debt, related parties (Notes 3 and 6)	64	64
Current maturities of capital lease obligations (Note 4)	327	300
Checks in excess of bank	342	148
Accounts payable	3,422	1,784
Payables and accrued expenses to related parties (Note 6)	6	173
Income tax payable	10	2
Other current liabilities	541	765
Total current liabilities	11,636	8,254
Long-term liabilities		
Long-term debt, net of current maturities	57	—
Long-term debt, net of current maturities, related parties (Notes 3 and 6)	1,504	1,536
Capital lease obligations, net of current maturities (Note 4)	698	819
Total long-term liabilities	2,259	2,355
Shareholders' equity		
Common stock, $0.0033 par value: 20.0 million shares authorized in 2018 and 2017; 8,107,865 and 8,089,129 shares issued and outstanding in 2018 and 2017	27	27
Additional paid-in capital	24,051	24,028
Stock warrants outstanding	1,025	1,025
Retained losses	(12,945)	(13,778)
Treasury stock at cost, 30,690 shares in 2018 and 2017	(44)	(44)
Total shareholders' equity	12,114	11,258
Total liabilities and shareholders' equity	$ 26,009	$ 21,867

See accompanying notes to condensed consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
THREE AND SIX MONTHS ENDED JUNE 30, 2018 AND 2017

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

	For the three months ended		**For the six months ended**	
	June 30, 2018	**June 30, 2017**	**June 30, 2018**	**June 30, 2017**
Revenue from product sales				
Revenue from ferrous operations	$ 8,003	$ 5,300	$ 15,048	$ 9,897
Revenue from non-ferrous operations	8,292	7,875	15,607	15,870
Revenue from auto parts operations and other revenue	305	385	602	804
Total revenue from product sales	16,600	13,560	31,257	26,571
Cost of sales for product sales	15,103	12,880	28,548	24,960
Gross profit	1,497	680	2,709	1,611
Selling, general and administrative expenses	893	856	1,819	1,898
Income (loss) before other income (expense)	604	(176)	890	(287)
Other income (expense)				
Interest expense, including loan fee amortization	(282)	(202)	(524)	(385)
Gain on sale of assets	—	—	—	28
Gain on insurance proceeds	487	—	487	—
Other income (expense), net	—	1	—	3
Total other income (expense), net	205	(201)	(37)	(354)
Income (loss) before income taxes	809	(377)	853	(641)
Income tax provision	12	—	20	7
Net income (loss)	$ 797	$ (377)	$ 833	$ (648)
Basic earnings (loss) per share	$ 0.10	$ (0.05)	$ 0.10	$ (0.08)
Diluted earnings (loss) per share	$ 0.10	$ (0.05)	$ 0.10	$ (0.08)
Weighted average shares outstanding:				
Basic	8,102	8,075	8,096	8,075
Diluted	8,170	8,075	8,142	8,075

See accompanying notes to condensed consolidated financial statements.

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INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
SIX MONTHS ENDED JUNE 30, 2018

(UNAUDITED)

	Common Stock			**Stock Warrants**	**Retained Losses**	**Treasury Stock**		**Total Shareholders' Equity**
	Shares	**Amount**	**Additional Paid-in Capital**			**Shares**	**Cost**	
	(in thousands, except share information)							
Balance as of December 31, 2017	8,119,819	$ 27	$ 24,028	$ 1,025	$ (13,778)	(30,690)	$ (44)	$ 11,258
Common stock	18,736	—	—	—	—	—	—	—
Share-based compensation	—	—	23	—	—	—	—	23
Net income	—	—	—	—	833	—	—	833
Balance as of June 30, 2018	8,138,555	$ 27	$ 24,051	$ 1,025	$ (12,945)	(30,690)	$ (44)	$ 12,114

See accompanying notes to condensed consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

SIX MONTHS ENDED JUNE 30, 2018 AND 2017

(UNAUDITED)

	For the six months ended June 30, 2018 (in thousands)	June 30, 2017
Cash flows from operating activities		
Net income (loss)	$ 833	$ (648)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Bad debt expense	—	25
Depreciation and amortization	1,042	1,135
Share-based compensation expense	23	59
Gain on sale of assets	—	(28)
Gain from insurance proceeds	(487)	—
Amortization of loan fees included in interest expense	71	64
Change in assets and liabilities		
Receivables	(2,042)	(1,610)
Receivables from related parties	44	105
Inventories	(2,883)	(694)
Income tax receivable/payable	8	10
Other assets	(188)	(154)
Accounts payable	1,638	(42)
Payables and accrued expenses to related parties	(167)	(240)
Other current liabilities	(224)	(13)
Net cash used in operating activities	(2,332)	(2,031)
Cash flows from investing activities		
Proceeds from insurance claim, net	487	—
Proceeds from sale of property and equipment	—	28
Purchases of property and equipment	(104)	(75)
Net cash from (used in) investing activities	383	(47)
Cash flows from financing activities		
Loan fees capitalized	(109)	(125)
Change in checks in excess of bank	194	(65)
Payments on related party debt	(32)	—
Payments on capital lease obligations	(148)	(63)
Proceeds from revolving line of credit, net	1,894	2,705

Net cash from financing activities	1,799	2,452
Net change in cash and cash equivalents	(150)	374
Cash and cash equivalents at beginning of period	841	526
Cash and cash equivalents at end of period	$ 691	$ 900

Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 435	$ 296
Cash paid for taxes	14	2
Tax refunds received	1	5
Supplemental disclosure of noncash investing and financing activities:		
Equipment additions financed by debt	69	—
Equipment additions financed by capital lease obligations	54	37
Equipment additions financed by related party debt	—	129

See accompanying notes to condensed consolidated financial statements.

INDUSTRIAL SERVICES OF AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL

Industrial Services of America, Inc. (herein "ISA," the "Company," or other similar terms) is a Louisville, Kentucky-based company that buys, processes and markets ferrous and non-ferrous metals and other recyclable commodities and buys used autos in order to sell used auto parts. The Company purchases, processes and sells ferrous and non-ferrous scrap metal to steel mini-mills, integrated steel makers, foundries, refineries and processors. The Company purchases ferrous and non-ferrous scrap metal primarily from industrial and commercial generators of steel, aluminum, copper, brass, stainless steel and other metals as well as from scrap dealers and retail customers who deliver these materials directly to ISA facilities. The Company processes scrap metal through sorting, cutting, baling, and shredding operations. The shredding operations were restarted in May 2017, which had previously been idled in May 2015. The non-ferrous scrap recycling operations consist primarily of collecting, sorting and processing various grades of copper, aluminum, stainless steel and brass. The used automobile yard primarily purchases automobiles so that retail customers can locate and remove used parts for purchase.

The Company's core business is now focused on the metal recycling industry. During 2016, the Company announced that the Company formed a special committee of independent board members to evaluate various growth and strategic options. During the first quarter of 2017, the special committee concluded its work and reported to the Board. The Board accepted the special committee's recommendation to focus on returning the core recycling business to profitability. The Company intends to do this by increasing efficiencies and productivity, which included the commercial restart of the Company's auto shredder in the second quarter of 2017. The Company operates the auto shredder in the normal course of business subject to market conditions and operating needs. ISA will also evaluate other various options and remain alert for possible strategic partnerships, joint ventures and mergers/acquisitions.

On March 26, 2018, the Board appointed Todd L. Phillips as Chief Executive Officer. See Note 7 – Share-Based Compensation and Other Compensation Agreements. Mr. Phillips has been the Company's Chief Financial Officer since December 31, 2014 and President since September 30, 2016 and will continue to serve in these roles.

Liquidity

During the first quarter of 2017, the Company amended and extended its working capital line of credit which extended the contractual maturity date to February 28, 2020 and increased the borrowing availability. On June 4, 2018, the

Company entered into an amendment to further increase the borrowing availability of its working capital line of credit. See Note 3 – Long-Term Debt and Notes Payable to Bank for discussion of loan arrangements with MidCap Business Credit LLC ("MidCap"). The Company expects operating cash flow and borrowings under its working capital line of credit to be sufficient to meet its ongoing obligations.

The borrowings under the working capital line of credit are classified as short-term obligations under GAAP as the agreement with the lender contains a subjective acceleration clause and requires the Company to maintain a lockbox arrangement with the lender. However, the contractual maturity date of the revolver is February 28, 2020.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") 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 GAAP for complete consolidated financial statements. The Accounting Standards Codification ("ASC") as produced by the Financial Accounting Standards Board ("FASB") is the sole source of authoritative GAAP. In the opinion of management of the Company, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position at June 30, 2018, and the results of operations and changes in cash flows for the quarters ended June 30, 2018 and 2017. Results of operations for the period ended June 30, 2018 are not necessarily indicative of the results that may be expected for the entire year. Additional information, including the audited December 31, 2017 consolidated financial statements and the Summary of Significant Accounting Policies, is included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, on file with the Securities and Exchange Commission.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL, Continued

Estimates

In preparing the consolidated financial statements in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, management must make estimates and assumptions. These estimates and assumptions affect the amounts reported for assets, liabilities, revenues and expenses, as well as affecting the disclosures provided. Examples of estimates include the allowance for doubtful accounts, estimates of deferred income tax assets and liabilities, estimates of inventory balances, and estimates of stock option and warrant values. The Company also uses estimates when assessing fair values of assets and liabilities acquired in business acquisitions as well as any fair value and any related impairment charges related to the carrying value of inventory and machinery and equipment and other long-lived assets. Despite the Company’s intention to establish accurate estimates and use reasonable assumptions, actual results may differ from these estimates.

Principles of Consolidation

The Condensed Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. Upon consolidation, all inter-company accounts, transactions and profits have been eliminated.

Reclassifications

The Company has reclassified certain items within the accompanying Condensed Consolidated Financial Statements and Notes to Condensed Consolidated Financial Statements for the prior year in order to be comparable with the current presentation. These reclassifications had no effect on previously reported net income (loss) or shareholders' equity.

Revenue Recognition

The Company's revenue is primarily generated from contracts with customers. The Company notes there have been no credit losses recorded on any receivables or contract assets arising from contracts with customers for the three and six months periods ended June 30, 2018 and 2017. The Company elects to use the practical expedient as it relates to significant financing components as the Company expects, at the contract inception, that the period between when the Company transfers a promised good and when the customer pays for that good will be one year or less.

Ferrous and nonferrous revenue

Ferrous and non-ferrous contracts contain one performance obligation which consists of the shipment of a stated quantity of a stated product to be delivered within a stated time frame. Ferrous and non-ferrous revenue contracts are primarily short term contracts, typically completed within 30 days. Ferrous and non-ferrous transaction prices are stated in the contract with no variable considerations present. As ferrous and non-ferrous contracts contain one performance obligation, the total transaction price is allocated to the shipment of materials. When multiple loads are included in one contract, the stated price per gross tons is applied to the shipment weight in order to determine transaction price. Ferrous and non-ferrous revenue is recognized when the Company satisfies the shipment of materials per the contract. The shipment and delivery of material typically occurs on the same day. No contract assets or contract liabilities were recognized as of June 30, 2018 and 2017.

Revenue from auto parts operations and other revenue

Revenue from auto parts primarily consists of individual transactions by customers who enter the Company's premises and purchase auto parts by cash or credit card. Related to these sales, a customer may be charged a core charge. The customer has 30 days to return the core and receive a refund of the core charge. Additionally, customers have the option to separately purchase a warranty related to certain goods purchased. Total core charges and warranty sales are immaterial, in aggregate accounting for less than 1% of revenue from auto parts operations and other revenue. Sale prices, core charges and warranties are tracked separately and recognized as revenue when the purchase is completed. No contract assets or contract liabilities were recognized as of June 30, 2018 and 2017.

Fair Value

The Company carries certain of its financial assets and liabilities at fair value on a recurring basis. These financial assets and liabilities are composed of cash and cash equivalents. Long-term debt is carried at cost, and the fair value is disclosed herein. In addition, the Company measures certain assets, such as long-lived assets, at fair value on a non-recurring basis to evaluate those assets for potential impairment. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL, Continued

In accordance with applicable accounting standards, the Company categorizes its financial assets and liabilities into the following fair value hierarchy:

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

Level 2 – Financial assets and liabilities with values based on quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability. Examples of Level 2 financial instruments include various types of interest-rate and commodity-based derivative instruments, and various types of fixed-income investment securities. Pricing models are utilized to estimate fair value for certain financial assets and liabilities categorized in Level 2.

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

When determining the fair value measurements for financial assets and liabilities carried at fair value on a recurring basis, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability. When possible, ISA looks to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, the Company looks to market observable data for similar assets and liabilities. Nevertheless, certain assets and liabilities are not actively traded in observable markets, and the Company uses alternative valuation techniques to derive fair value measurements.

The Company uses the fair value methodology outlined in the related accounting standards to value the assets and liabilities for cash and debt. All of our cash is defined as Level 1 and all our debt is defined as Level 2.

In accordance with this guidance, the following table represents our fair value hierarchy for Level 1 and Level 2 financial instruments at June 30, 2018 and December 31, 2017 (in thousands):

	Fair Value at Reporting Date Using
June 30, 2018: unaudited	

Assets:	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Total
Cash and cash equivalents	$ 691	$ —	$ 691
Liabilities:			
Long-term debt	$ —	$ (6,966)	$ (6,966)
Long-term debt, related parties	—	(1,339)	(1,339)

December 31, 2017:	Fair Value at Reporting Date Using		
Assets:	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Total
Cash and cash equivalents	$ 841	$ —	$ 841
Liabilities:			
Current maturities of long-term debt	$ —	$ (5,018)	$ (5,018)
Long-term debt, related parties	—	(1,331)	(1,331)

The Company had no transfers in or out of Levels 1 or 2 fair value measurements, and no activity in Level 3 fair value measurements for the six month periods ended June 30, 2018 or 2017.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL, Continued

Common Stock and Share-based Compensation Arrangements

The Company has a Long Term Incentive Plan adopted in 2009 ("LTIP") under which it may grant equity awards for up to 2.4 million shares of common stock, which are reserved by the Board of Directors for issuance of equity awards. The Company provides compensation benefits by granting stock options and other share-based awards to employees and directors. The exercise price of each option is equal to the market price of the Company's stock on the date of grant. The maximum term of the option is five years. The plan is accounted for based on FASB's authoritative guidance titled "ASC 718 - Compensation - Stock Compensation." The Company recognizes share-based compensation expense for the fair value of the awards, on the date granted, on a straight-line basis over their vesting term (service period). Compensation expense is recognized only for share-based payments expected to vest. The Company estimates forfeitures at the date of grant based on the Company's historical experience and future expectations.

The Company uses the grant date stock price to value the Company's restricted stock units. The fair value of each restricted stock unit is estimated on the date of grant.

The Company uses the Modified Black-Scholes-Merton option-pricing model to value the Company's stock options for each employee stock option award. See Note 7 – Share-Based Compensation and Other Compensation Agreements. Using these option pricing models, the fair value of each stock option award is estimated on the date of grant.

There are two significant inputs into the stock option pricing models: expected volatility and expected term. The Company estimates expected volatility based on traded option volatility of the Company's stock over a term equal to the expected term of the option granted. The expected term of stock option awards granted is derived from historical exercise experience under the Company's stock option plans and represents the period of time that stock option awards granted are expected to be outstanding.

The expected term assumption incorporates the contractual term of an option grant, as well as the vesting period of an award. The risk-free interest rate is based on the implied yield on a U.S. Treasury constant maturity with a remaining term equal to the expected term of the option granted. The assumptions used in calculating the fair value of stock-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if factors change and different assumptions are used, stock-based compensation expense could be materially different in the future. In addition, the Company is required to estimate the expected forfeiture rate, and only recognize expense for those shares expected to vest. If the actual forfeiture rate is materially different from the estimate, the stock-based compensation expense could be significantly different from what was recorded in the current period.

Treasury shares or new shares are issued for exercised options. The Company does not expect to repurchase any additional shares within the following annual period to accommodate the exercise of outstanding stock options.

Under the LTIP, the Company may grant any of these types of awards: non-qualified and incentive stock options; stock appreciation rights; and other stock awards including stock units, restricted stock units, performance shares, performance units and restricted stock. The performance goals that the Company may use for such awards will be based on any one or more of the following performance measures: cash flow; earnings; earnings per share; market value added or economic value added; profits; return on assets; return on equity; return on investment; revenues; stock price; or total shareholder return.

The LTIP is administered by a committee selected by the Board consisting of two or more outside members of the Board. The Committee may grant one or more awards to our employees, including our officers, our directors and consultants, and will determine the specific employees who will receive awards under the plan and the type and amount of any such awards. A participant who receives shares of stock awarded under the plan must hold those shares for six months before the participant may dispose of such shares.

Gain on Insurance Proceeds

The Company filed an insurance claim related to six roofs on certain of its buildings due to weather related damage. In 2016, the Company received insurance proceeds and recorded a gain net of impairment write-downs of the related roofs and consulting fees related to the claim. In the second quarter of 2018, the Company received additional insurance proceeds in the amount of $744.9 thousand and recorded a gain, net of expenses and consulting fees related to the claim, of $487.4 thousand.

Subsequent Events

The Company has evaluated the period from June 30, 2018 through the date the financial statements herein were issued for subsequent events requiring recognition or disclosure in the financial statements and identified the following:

On July 9, 2018, the Compensation Committee of the Board of Directors of the Company granted each of the four non-employee directors 13,228 restricted stock units in accordance with a Restricted Stock Unit Grant Agreement pursuant to the Company’s 2009 Long Term Incentive Plan, as amended. The grants followed the election of the non-employee directors at the annual meeting of shareholders of the Company on July 9, 2018.

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL, Continued

Beginning July 1, 2018, the Company's line of credit minimum line covenant was replaced by a Fixed Charge Coverage Ratio covenant with a result of an increase in availability of $350.0 thousand. See Note 3 – Long-Term Debt and Notes Payable to Bank for additional information.

Impact of Recently Issued Accounting Standards

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606).* The amendments in ASU 2014-09 affect any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (*e.g.*, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. On January 1, 2018, the Company adopted ASU 2014-09 using the retrospective approach. The Company noted no financial impact on the Condensed Consolidated Financial Statements as a result of the adoption of this amended guidance. In addition, the adoption of this new accounting standard resulted in increased disclosure, including qualitative and quantitative disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. See the Revenue Recognition section of Note 1 – Summary of Significant Accounting Policies and General for additional information.

In November 2015, the FASB issued ASU 2015-17, *Balance Sheet Classification of Deferred Taxes*, which requires that deferred tax assets and liabilities be classified as noncurrent on the consolidated balance sheet. ASU 2015-17 was effective for annual periods beginning after December 15, 2016, including interim periods within those annual periods. Upon adoption, ASU 2015-17 may be applied either prospectively or retrospectively. The Company adopted the standard in the first quarter of 2017 and noted no material impact from the adoption on the Condensed Consolidated Financial Statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, to improve financial reporting about leasing transactions. This ASU will require organizations that lease assets ("lessees") to recognize a lease liability and a right-of-use asset on its balance sheet for all leases with terms of more than twelve months. A lease liability is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis and a right-of-use asset represents the lessee's right to use, or control use of, a specified asset for the lease term. The amendments in this ASU simplify the accounting for sale and leaseback transactions. This ASU leaves the accounting for the organizations that own the leased assets largely unchanged except for targeted improvements to align it with the lessee accounting model and Topic 606, *Revenue from Contracts with Customers*.

The amendments in ASU 2016-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is evaluating the potential impact of ASU 2016-02 on the Condensed Consolidated Financial Statements and expects to record a right-of-use asset and a lease liability. The Company does not expect a significant impact on the Company's results of operations.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses*, which provides guidance to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. ASU 2016-13 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. The Company is evaluating the potential impact of ASU 2016-13 on the Condensed Consolidated Financial Statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows, Classification of Certain Cash Receipts and Cash Payments*, which provides guidance on eight specific cash flow issues. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Upon adoption, ASU 2016-15 should be applied retrospectively. The Company is evaluating the potential impact of ASU 2016-15 on the Condensed Consolidated Financial Statements, but does not expect a material impact from the adoption of ASU 2016-15 on the Condensed Consolidated Financial Statements.

No other new accounting pronouncements issued or effective during the reporting period had, or is expected to have, a material impact on our Condensed Consolidated Financial Statements.

NOTE 2 – INVENTORIES

The Company's inventories primarily consist of ferrous and non-ferrous scrap metals, and are valued at the lower of average purchased cost or net realizable value ("NRV") based on the specific scrap commodity. Quantities of inventories are determined based on the Company's inventory systems and are subject to periodic physical verification using estimation techniques including observation, weighing and other industry methods. The Company recognizes inventory impairment and related adjustments when the NRV, based upon current market pricing, falls below recorded value or when the estimated volume is less than the recorded volume of the inventory. The Company records the loss in cost of sales in the period during which the loss is identified.

Certain assumptions are made regarding future demand and net realizable value in order to assess whether inventory is properly recorded at the lower of cost or NRV. Assumptions are based on historical experience, current market conditions and remaining costs of processing (if any) and disposal. If the anticipated future selling prices of scrap metal and finished steel products should decline, the Company would re-assess the recorded NRV of the inventory and make any adjustments believed necessary in order to reduce the value of the inventory (and increase cost of sales) to the lower of cost or NRV.

The Company did not have a lower of cost or NRV inventory write-down in the six month periods ended June 30, 2018 and 2017.

Some commodities are in saleable condition at acquisition. The Company purchases these commodities in small amounts until it has a truckload of material available for shipment. Some commodities are not in saleable condition at acquisition. These commodities must be sorted, shredded, cut or baled. ISA does not have work-in-process inventory that needs to be manufactured to become finished goods. The Company includes processing costs in inventory for all commodities by weight.

Inventories for ferrous and non-ferrous materials as of June 30, 2018 and December 31, 2017 consist of the following:

	June 30, 2018 (unaudited) (in thousands)		**December 31, 2017**	
Raw materials	$	5,616	$	3,046
Finished goods	1,428		1,366	
Processing costs	945		694	
Total inventories for sale	$	7,989	$	5,106

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

Summary:

On February 29, 2016, the Company closed on new financings with MidCap and paid off all remaining amounts due to the Company's previous lender Wells Fargo. Additionally, on February 29, 2016, the Company converted certain amounts payable to related parties into unsecured term notes payable to the same related parties as more fully described in Note 6 – Related Party Transactions. On March 31, 2017, the Company entered into an amendment to increase the line of credit, subject to the satisfaction of certain borrowing base restrictions (which have been satisfied), and extend the maturity date more fully described below. On June 23, 2017, in connection with the purchase of equipment to be used in the operation of the Company's business, the Company issued notes totaling $129.0 thousand principal amount due to a related party. See Note 6 – Related Party Transactions.

MidCap:

On February 29, 2016, the Company entered into the 2016 Loan, which, as initially entered into, provided a $6.0 million senior, secured asset-based line of credit with MidCap. The Company could borrow up to the sum of (a) 85% of the value of its eligible domestic accounts receivable; (b) the lesser of (i) $2.5 million and (ii) 75% of the net orderly liquidation value of eligible inventory; and (c) the lesser of (i) $500,000 and (ii) 40% of appraised net forced liquidation value of eligible fixed assets (the "Equipment Sublimit"). The Equipment Sublimit amortizes monthly on a straight line basis over sixty (60) months with no reduction to the overall line of credit availability. As described below, the 2016 Loan was amended on March 31, 2017 and June 4, 2018.

Proceeds from this loan were used to pay transaction expenses, pay off and close the remaining balance on the Wells Fargo revolving line of credit and fund working capital requirements.

The interest rate on the 2016 Loan is equal to the prime rate (5.00% as of June 30, 2018) plus 250 basis points (2.50%). In the Event of a Default (as defined in the 2016 Loan Agreement), the interest rate will increase by 300 basis points (3.00%). The 2016 Loan also has a monthly collateral-monitoring fee equal to 27.5 basis points (0.275%) of the average daily balance outstanding, an annual facility fee of 100 basis points (1.00%) and an unused line fee equal to an annual rate of 50 basis points (0.50%) of the average undrawn portion of the 2016 Loan.

The 2016 Loan has a maturity date of February 28, 2020 based on the amendment described below. The borrowings under the revolving credit agreement are classified as short-term obligations under GAAP as the agreement with MidCap contains a subjective acceleration clause and requires the Company to maintain a lockbox arrangement with the lender.

The Company was subject to a prepayment fee of $120.0 thousand if the 2016 Loan was terminated or prepaid prior to the one year anniversary of the loan. The Company is subject to a prepayment fee of $60.0 thousand if the 2016 Loan is terminated or prepaid subsequent to the one year anniversary of the loan, but prior to the maturity date. After 18 months subsequent to the loan origination date, no termination fee shall be owed by the Company in the event the Company pays the obligation with initial proceeds of loans made under a loan facility provided to the Company by a financial institution insured under the Federal Deposit Insurance Corporation.

Interest and monthly fees under the 2016 Loan are payable monthly in arrears.

The 2016 Loan Agreement contains a minimum line availability covenant equal to $350.0 thousand. This covenant may be replaced by a Fixed Charge Coverage Ratio ("FCCR") covenant once the Company has achieved a FCCR of 1.0x on an annualized basis.

The Company granted MidCap a first priority security interest in all of the assets of ISA pursuant to the terms of a Security Agreement.

The Company is allowed to sell or refinance up to $3.0 million in fair market value of real property provided (i) the proceeds from such refinance or sale remain with the Company; and (ii) no event of default exists at the time of such refinance or sale.

On March 31, 2017, the Company and each of its wholly-owned subsidiaries entered into an amendment to the 2016 Loan with MidCap ("First Amendment"). The First Amendment increased the line of credit from $6.0 million to $8.0 million and extended the maturity date to February 28, 2020. As amended, the line of credit permits the Company to borrow an amount under the 2016 Loan equal to the lesser of (A) $8.0 million and (B)(i) 85% of the value of the Company’s eligible domestic accounts receivable, plus (ii) the lesser of (x) $2.5 million and (y) 75% of the net orderly liquidation value of eligible inventory, plus (iii) the lesser of (x) $400,000 and (y) 40% of appraised net forced liquidation value of eligible fixed assets, plus (iv) the lesser of (x) $1.75 million and (y) 45% of the appraised value of certain properties owned by the Company (subject to MidCap's receipt of any third-party or internal approvals it may require in its discretion), minus (v) any amount which MidCap may require from time to time, pursuant to terms of the agreement, in order to secure amounts owed to MidCap under the agreement. The First Amendment contains a minimum line availability covenant equal to $350.0 thousand, the same as the original 2016 Loan. This covenant may be replaced by a FCCR covenant once the Company has achieved an FCCR of 1.1x on an annualized basis. The Company paid underwriting fees of $20.0 thousand at closing.

NOTE 3 – LONG-TERM DEBT AND NOTES PAYABLE TO BANK, Continued

On April 26, 2017, certain borrowing base restrictions were satisfied with MidCap which resulted in an increase in availability of $1.75 million.

On June 4, 2018, the Company and each of its wholly-owned subsidiaries entered into an amendment to the 2016 Loan with MidCap ("Second Amendment"). The Second Amendment, among other things, increased the Company's line of credit from $8.0 million to $10.0 million. The Company also entered into a Second Amended and Restated Revolving Note to evidence amounts borrowed from MidCap under the 2016 Loan. The Company paid fees of $15.0 thousand at closing.

In June 2018, the Company achieved an FCCR greater than 1.1x on an annual basis. Beginning July 1, 2018 the minimum line covenant equal to $350.0 thousand will be replaced by an FCCR covenant with a result of an increase in availability of $350.0 thousand.

The amended 2016 Loan had availability of $1.8 million as of June 30, 2018.

Other Debt:

Amounts owed to K&R, LLC and 7100 Grade Lane LLC are more fully described in Note 6 – Related Party Transactions.

In June 2018, the Company executed a note for $68.9 thousand to purchase equipment to be used in the operation of the Company's business. The note is for a period of five years at an interest rate of 6.0% with a monthly payment of $1.3 thousand.

Debt as of June 30, 2018 and December 31, 2017 consisted of the following:

	June 30, 2018 (unaudited)	**December 31, 2017**

	(in thousands)	
Revolving credit facility with MidCap, see above description for additional details	$ 6,912	$ 5,018
K&R, LLC related party notes (See Note 6 - Related Party Transactions)	684	716
7100 Grade Lane LLC related party note (See Note 6 - Related Party Transactions)	884	884
Equipment note, see above description for additional details	69	—
	8,549	6,618
Less amounts classified as current maturities	6,988	5,082
	$ 1,561	$ 1,536

The annual contractual maturities of long-term debt (in thousands) for the next five twelve-month periods and thereafter ending June 30 are as follows:

2019	$	77
2020	6,924	
2021	1,518	
2022	15	
2023	15	
Total	$	8,549

The Company paid and capitalized loan fees in the amount of $109.1 thousand during the six month period ended June 30, 2018. The Company recognized loan amortization expense of $71.0 thousand during the six month period ended June 30, 2018.

NOTE 4 – LEASE COMMITMENTS

Operating Leases:

The Company leased a portion of its Louisville, Kentucky facility from a related party (see Note 6 - Related Party Transactions) under an operating lease that was due to expire December 31, 2017 (the "7100 Prior Lease"). The lease amount was $53.8 thousand per month. Effective October 1, 2017, the Company entered into a new lease agreement with a related party for the same property (the "7100 Lease") that terminates and replaces the 7100 Prior Lease. The lease is for a period of seven years with rent payments of $37.5 thousand per month for the first five years. For each of the following one year periods, the annual rent increases the lesser of (a) the percentage change in the CPI over the preceding twelve months, or (b) 2% of the previous year's annual rent. The Company has the option to extend the lease for two additional consecutive terms, each such extended term to be for a period of five years. In addition, the Company is responsible for real estate taxes, insurance, utilities and maintenance expense.

The Company signed a lease, effective December 1, 2014, to lease a facility in the Seymour, Indiana area. This lease was for an initial period of three years, with the option to extend the lease for