

FLEXIBLE SOLUTIONS INTERNATIONAL INC  
Form 10-Q  
November 12, 2010

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, DC 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2010

OR

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

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

Commission File Number: 001-31540

**FLEXIBLE SOLUTIONS INTERNATIONAL INC.**

(Exact Name of Issuer as Specified in Its Charter)

Nevada

91-1922863

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

615 Discovery St.  
Victoria, British Columbia, Canada

V8T 5G4

(Address of Issuer's Principal Executive Offices)

(Zip Code)

Issuer's telephone number: (250) 477-9969

N/A

(Former name, former address and former fiscal year, if changed since last report)

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) had 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 during the preceding 12 months (or for such shorter period that

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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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes

No

| <b>Class of Stock</b> | <b>No. Shares Outstanding</b> | <b>Date</b>      |
|-----------------------|-------------------------------|------------------|
| Common                | 13,962,567                    | November 5, 2010 |

FORM 10-Q

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This document contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are forward-looking statements for the purposes of the federal and state securities laws, including, but not limited to any projections of earnings, revenue or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements concerning proposed new services or developments; any statements regarding future economic conditions or performance; any statements regarding future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing.

Forward-looking statements may include the words may, could, will, estimate, intend, continue, believe, expect or anticipate, or similar words. These forward-looking statements present our estimates and assumptions only as of the date of this report. Except for our ongoing obligation to disclose material information as required by the federal securities laws, we do not intend, and undertake no obligation, to update any forward-looking statement.

Although we believe that the expectations reflected in any of our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed in any of our forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to change and inherent risks and uncertainties. The factors impacting these risks and uncertainties include but are not limited to:

Increased competitive pressures from existing competitors and new entrants;

Increases in interest rates or our cost of borrowing or a default under any material debt agreement;

Deterioration in general or regional economic conditions;

Adverse state or federal legislation or regulation that increases the costs of compliance, or adverse findings by a regulator with respect to existing operations;

Loss of customers or sales weakness;

Inability to achieve future sales levels or other operating results;

The unavailability of funds for capital expenditures; and

Operational inefficiencies in distribution or other systems.

For a detailed description of these and other factors that could cause actual results to differ materially from those expressed in any forward-looking statement, please see Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009.

**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.**

**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**At September 30, 2010**  
**(U.S. Dollars)**

|                                                            | <b>September<br/>30,<br/>2010<br/>(Unaudited)</b> | <b>December 31,<br/>2009</b> |
|------------------------------------------------------------|---------------------------------------------------|------------------------------|
|                                                            | <u>          </u>                                 | <u>          </u>            |
| <b>Assets</b>                                              |                                                   |                              |
| <b>Current</b>                                             |                                                   |                              |
| Cash and cash equivalents                                  | \$ 1,849,773                                      | \$ 2,126,150                 |
| Accounts receivable                                        | 1,993,161                                         | 1,544,364                    |
| Inventory                                                  | 2,547,337                                         | 2,796,307                    |
| Prepaid expenses                                           | 253,105                                           | 121,353                      |
|                                                            | <u>6,643,377</u>                                  | <u>6,588,175</u>             |
| Property, equipment and leaseholds                         | 7,588,409                                         | 7,314,926                    |
| Patents                                                    | 220,379                                           | 224,505                      |
| Long term deposits                                         | 7,648                                             | 7,499                        |
| Deferred tax asset                                         | 89,000                                            | 119,000                      |
|                                                            | <u>\$ 14,548,812</u>                              | <u>\$ 14,254,105</u>         |
| <b>Liabilities</b>                                         |                                                   |                              |
| <b>Current</b>                                             |                                                   |                              |
| Accounts payable and accrued liabilities                   | \$ 420,631                                        | \$ 597,307                   |
| Deferred revenue                                           | 25,000                                            |                              |
| Taxes payable                                              | 330,000                                           | 304,000                      |
| Current portion of long term loan                          | 117,639                                           | 74,146                       |
|                                                            | <u>893,270</u>                                    | <u>975,453</u>               |
| <b>Long Term</b>                                           |                                                   |                              |
| Loans                                                      | 2,162,442                                         | 2,211,168                    |
|                                                            | <u>\$ 3,055,713</u>                               | <u>\$ 3,186,621</u>          |
| <b>Stockholders Equity</b>                                 |                                                   |                              |
| <b>Capital stock</b>                                       |                                                   |                              |
| Authorized                                                 |                                                   |                              |
| 50,000,000 Common shares with a par value of \$0.001 each  |                                                   |                              |
| 1,000,000 Preferred shares with a par value of \$0.01 each |                                                   |                              |
| Issued and outstanding                                     |                                                   |                              |
| 13,962,567 (2009: 13,962,567) common shares                | 13,963                                            | 13,963                       |
| <b>Capital in excess of par value</b>                      | 16,565,441                                        | 16,456,903                   |
| <b>Other comprehensive income</b>                          | 421,621                                           | 331,208                      |
| <b>Deficit</b>                                             | <u>(5,507,925)</u>                                | <u>(5,734,591)</u>           |

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|                                                                                 |                      |                      |
|---------------------------------------------------------------------------------|----------------------|----------------------|
| <b>Total Stockholders Equity</b>                                                | <u>11,493,100</u>    | <u>11,067,483</u>    |
| <b>Total Liabilities and Stockholders Equity</b>                                | <u>\$ 14,548,812</u> | <u>\$ 14,254,105</u> |
| <b>Commitments, Contingencies and Subsequent Events (Notes 13, 14 &amp; 15)</b> |                      |                      |

See Notes to Unaudited Consolidated Financial Statements

**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Three Months Ended September 30, 2010 and 2009**  
**(U.S. Dollars Unaudited)**

|                                                        | <u>Three Months Ended September 30,</u> |                   |
|--------------------------------------------------------|-----------------------------------------|-------------------|
|                                                        | <u>2010</u>                             | <u>2009</u>       |
| <b>Sales</b>                                           | \$ 2,676,921                            | \$ 2,448,994      |
| <b>Cost of sales</b>                                   | 1,833,666                               | 1,476,046         |
| <b>Gross profit</b>                                    | <u>843,255</u>                          | <u>972,948</u>    |
| <b>Operating expenses</b>                              |                                         |                   |
| Wages                                                  | 448,281                                 | 343,656           |
| Administrative salaries and benefits                   | 63,070                                  | 107,627           |
| Advertising and promotion                              | 12,004                                  | 6,567             |
| Investor relations and transfer agent fee              | 24,970                                  | 29,874            |
| Office and miscellaneous                               | 155,294                                 | 159,854           |
| Insurance                                              | 51,511                                  | 49,026            |
| Interest expense                                       | 17,313                                  | 19,741            |
| Rent                                                   | 42,807                                  | 65,859            |
| Consulting                                             | 23,583                                  | 42,565            |
| Professional fees                                      | 50,634                                  | 58,152            |
| Travel                                                 | 29,741                                  | 34,807            |
| Telecommunications                                     | 8,734                                   | 9,319             |
| Shipping                                               | 7,063                                   | 11,672            |
| Research                                               | 18,954                                  | 8,300             |
| Commissions                                            | 10,525                                  | 8,510             |
| Currency exchange                                      | 2,548                                   | 91,147            |
| Utilities                                              | 22,497                                  | 16,762            |
|                                                        | <u>989,530</u>                          | <u>1,063,447</u>  |
| <b>Income (loss) before income tax</b>                 | <u>(146,275)</u>                        | <u>(90,499)</u>   |
| <b>Income tax</b>                                      | <u>9,140</u>                            | <u>71,183</u>     |
| <b>Net income (loss)</b>                               | <u>(155,415)</u>                        | <u>(161,862)</u>  |
| <b>Net income (loss) per share (basic and diluted)</b> | <u>\$ (0.01)</u>                        | <u>\$ (0.01)</u>  |
| <b>Weighted average number of common shares</b>        | <u>13,962,567</u>                       | <u>13,962,567</u> |

See Notes to Unaudited Consolidated Financial Statements

**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Nine Months Ended September 30, 2010 and 2009**  
**(U.S. Dollars Unaudited)**

|                                                        | <u>Nine Months Ended September 30,</u> |                   |
|--------------------------------------------------------|----------------------------------------|-------------------|
|                                                        | <u>2010</u>                            | <u>2009</u>       |
| <b>Sales</b>                                           | \$ 8,895,319                           | \$ 7,381,301      |
| <b>Cost of sales</b>                                   | 5,278,845                              | 5,058,024         |
| <b>Gross profit</b>                                    | <u>3,616,474</u>                       | <u>2,323,277</u>  |
| <b>Operating expenses</b>                              |                                        |                   |
| Wages                                                  | 1,239,072                              | 1,023,809         |
| Administrative salaries and benefits                   | 242,141                                | 290,038           |
| Advertising and promotion                              | 64,202                                 | 49,835            |
| Investor relations and transfer agent fee              | 73,817                                 | 39,393            |
| Office and miscellaneous                               | 349,918                                | 332,066           |
| Insurance                                              | 150,791                                | 124,769           |
| Interest expense                                       | 54,407                                 | 47,431            |
| Rent                                                   | 126,365                                | 187,211           |
| Consulting                                             | 80,366                                 | 120,676           |
| Professional fees                                      | 143,035                                | 171,919           |
| Travel                                                 | 80,678                                 | 97,438            |
| Telecommunications                                     | 27,360                                 | 23,749            |
| Shipping                                               | 23,421                                 | 33,125            |
| Research                                               | 66,808                                 | 21,025            |
| Commissions                                            | 87,980                                 | 57,867            |
| Bad debt expense (recovery)                            | 5,253                                  | (695)             |
| Currency exchange                                      | 5,092                                  | 98,342            |
| Utilities                                              | 77,879                                 | 43,850            |
|                                                        | <u>2,898,588</u>                       | <u>2,761,848</u>  |
| <b>Income (loss) before income tax</b>                 | <u>717,886</u>                         | <u>(438,571)</u>  |
| <b>Income tax</b>                                      | 491,220                                | 71,183            |
| <b>Net income (loss)</b>                               | 226,666                                | (509,754)         |
| <b>Net income (loss) per share (basic and diluted)</b> | <u>\$ 0.02</u>                         | <u>\$ (0.04)</u>  |
| <b>Weighted average number of common shares</b>        | <u>13,962,567</u>                      | <u>14,028,313</u> |

See Notes to Unaudited Consolidated Financial Statements



**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Nine Months Ended September 30, 2010 and 2009**  
**(U.S. Dollars Unaudited)**

|                                                          | <u>Nine Months Ended September 30,</u> |                     |
|----------------------------------------------------------|----------------------------------------|---------------------|
|                                                          | <u>2010</u>                            | <u>2009</u>         |
| <b>Operating activities</b>                              |                                        |                     |
| Net income (loss)                                        | \$ 226,666                             | \$ (509,754)        |
| Stock compensation expense                               | 108,539                                | 198,875             |
| Depreciation                                             | 266,483                                | 301,595             |
| Judgment from lawsuit                                    |                                        | (80,000)            |
| Changes in non-cash working capital items:               |                                        |                     |
| (Increase) Decrease in accounts receivable               | (450,232)                              | (38,251)            |
| (Increase) Decrease in inventory                         | 263,276                                | 1,067,756           |
| (Increase) Decrease in prepaid expenses                  | (130,286)                              | (26,307)            |
| (Increase) Decrease in deferred tax asset                | 30,000                                 |                     |
| Increase (Decrease) in accounts payable                  | (150,133)                              | (246,172)           |
| Increase (Decrease) in deferred revenue                  | 25,000                                 |                     |
| <b>Cash provided by (used in) operating activities</b>   | <u>189,313</u>                         | <u>667,742</u>      |
| <b>Investing activities</b>                              |                                        |                     |
| Long term deposits                                       |                                        | 13,911              |
| Development of patents                                   |                                        | (19,036)            |
| Acquisition of property and equipment                    | (428,598)                              | (1,569,395)         |
| <b>Cash provided by (used in) investing activities</b>   | <u>(428,598)</u>                       | <u>(1,574,520)</u>  |
| <b>Financing activities</b>                              |                                        |                     |
| Loan (repayment)                                         | (53,629)                               | 428,670             |
| <b>Cash provided by financing activities</b>             | <u>(53,629)</u>                        | <u>428,670</u>      |
| Effect of exchange rate changes on cash                  | 16,537                                 | 493,962             |
| <b>Inflow (outflow) of cash</b>                          | (276,377)                              | 15,854              |
| Cash and cash equivalents, beginning                     | 2,126,150                              | 1,894,045           |
| <b>Cash and cash equivalents, ending</b>                 | <u>\$ 1,849,773</u>                    | <u>\$ 1,909,899</u> |
| <b>Supplemental disclosure of cash flow information:</b> |                                        |                     |
| Income taxes paid                                        | \$ 491,220                             |                     |
| Interest paid                                            | \$ 54,407                              | \$ 47,431           |

See Notes to Unaudited Consolidated Financial Statements



**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Period Ended September 30, 2010**  
**(U.S. Dollars)**

**1. Basis of Presentation.**

These unaudited consolidated financial statements of Flexible Solutions International, Inc (the Company ) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. These financial statements are condensed and do not include all disclosures required for annual financial statements. The organization and business of the Company, accounting policies followed by the Company and other information are contained in the notes to the Company s audited consolidated financial statements filed as part of the Company s December 31, 2009 Annual Report on Form 10-K. This quarterly report should be read in conjunction with the annual report.

In the opinion of the Company s management, these consolidated financial statements reflect all adjustments necessary to present fairly the Company s consolidated financial position at September 30, 2010, and the consolidated results of operations and the consolidated statements of cash flows for the nine months ended September 30, 2010 and 2009. The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the entire fiscal year.

These consolidated financial statements include the accounts of the Company, and its wholly-owned subsidiaries Flexible Solutions, Ltd. ( Flexible Ltd. ), and NanoChem Solutions Inc. All inter-company balances and transactions have been eliminated. The Company was incorporated May 12, 1998 in the State of Nevada and had no operations until June 30, 1998.

The Company and its subsidiaries develop, manufacture and market specialty chemicals which slow the evaporation of water. The Company s primary product, HEAT\$AVR®, is marketed for use in swimming pools and spas where its use, by slowing the evaporation of water, allows the water to retain a higher temperature for a longer period of time and thereby reduces the energy required to maintain the desired temperature of the water in the pool. Another product, WATER\$AVR®, is marketed for water conservation in irrigation canals, aquaculture, and reservoirs where its use slows water loss due to evaporation. In addition to the water conservation products, the Company also manufactures and markets water-soluble chemicals utilizing thermal polyaspartate biopolymers (referred to as TPAs ), which are beta-proteins manufactured from the common biological amino acid, L-aspartic. TPAs can be formulated to prevent corrosion and scaling in water piping within the petroleum, chemical, utility and mining industries. TPAs are also used as proteins to enhance fertilizers in improving crop yields and as additives for household laundry detergents, consumer care products and pesticides.

**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Period Ended September 30, 2010**  
**(U.S. Dollars)**

**2. SIGNIFICANT ACCOUNTING POLICIES.**

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States applicable to a going concern and reflect the policies outlined below.

(a) *Cash and Cash Equivalents.*

The Company considers all highly liquid investments purchased with an original or remaining maturity of less than three months at the date of purchase to be cash equivalents. Cash and cash equivalents are maintained with several financial institutions.

(b) *Inventories and Cost of Sales*

The Company has four major classes of inventory: finished goods, work in progress, raw materials and supplies. In all classes, inventory is valued at the lower of cost and market. Cost is determined on a first-in, first-out basis. Cost of sales includes all expenditures incurred in bringing the goods to the point of sale. Inventory costs and costs of sales include direct costs of the raw material, inbound freight charges, warehousing costs, handling costs (receiving and purchasing) and utilities and overhead expenses related to the Company's manufacturing and processing facilities.

(c) *Allowance for Doubtful Accounts*

The Company provides an allowance for doubtful accounts when management estimates collectibility to be uncertain. Accounts receivable are continually reviewed to determine which, if any, accounts are doubtful of collection. In making the determination of the appropriate allowance amount, the Company considers current economic and industry conditions, relationships with each significant customer, overall customer credit-worthiness and historical experience.

(d) *Property, Equipment and Leaseholds.*

The following assets are recorded at cost and depreciated using the methods and annual rates shown below:

|                           |                               |
|---------------------------|-------------------------------|
| Computer hardware         | 30% Declining balance         |
| Automobile                | 30% Declining balance         |
| Trade show booth          | 30% Declining balance         |
| Furniture and fixtures    | 20% Declining balance         |
| Manufacturing equipment   | 20% Declining balance         |
| Office equipment          | 20% Declining balance         |
| Building and improvements | 10% Declining balance         |
| Leasehold improvements    | Straight-line over lease term |

Depreciation is recorded at half for the year the assets are first purchased. Property and equipment are written down to net realizable value when management determines there has been a change in circumstances which indicates its carrying amount may not be recoverable. No write-downs have been necessary to date.

**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Period Ended September 30, 2010**  
**(U.S. Dollars)**

Costs capitalized on self-constructed assets are classified as plant under construction and include contracted costs and supplies, but do not include capitalized interest costs. The Company does not commence depreciating its plant under construction until it becomes operational.

(e) *Impairment of Long-Lived Assets.*

In accordance with ASC 360, *Property, Plant and Equipment*, the Company reviews long-lived assets, including, but not limited to, property and equipment, patents and other assets, for impairment annually or whenever events or changes in circumstances indicate the carrying amounts of assets may not be recoverable. The carrying value of long-lived assets is assessed for impairment by evaluating operating performance and future undiscounted cash flows of the underlying assets. If the sum of the expected future cash flows of an asset is less than its carrying value, an impairment measurement is indicated. Impairment charges are recorded to the extent that an asset's carrying value exceeds its fair value. Accordingly, actual results could vary significantly from such estimates. There were no impairment charges during the periods presented.

(f) *Foreign Currency.*

The functional currency of one of the Company's subsidiaries is the Canadian Dollar. The translation of the Canadian Dollar to the reporting currency of the U.S. Dollar is performed for assets and liabilities using exchange rates in effect at the balance sheet date. Revenue and expense transactions are translated using average exchange rates prevailing during the year. Translation adjustments arising on conversion of the financial statements from the subsidiary's functional currency, Canadian Dollars, into the reporting currency, U.S. Dollars, are excluded from the determination of income (loss) and are disclosed as other comprehensive income (loss) in stockholders' equity.

Foreign exchange gains and losses relating to transactions not denominated in the applicable local currency are included in operating income (loss) if realized during the year and in comprehensive income (loss) if they remain unrealized at the end of the year.

(g) *Revenue Recognition.*

Revenue from product sales is recognized at the time the product is shipped since title and risk of loss are transferred to the purchaser upon delivery to the carrier. Shipments are made F.O.B. shipping point. The Company recognizes revenue when there is persuasive evidence of an arrangement, delivery to the carrier has occurred, the fee is fixed or determinable, collectibility is reasonably assured and there are no significant remaining performance obligations. When significant post-delivery obligations exist, revenue is deferred until such obligations are fulfilled. To date there have been no such significant post-delivery obligations.

Provisions are made at the time the related revenue is recognized for estimated product returns. Since the Company's inception, product returns have been insignificant; therefore no provision has been established for estimated product returns.

**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Period Ended September 30, 2010**  
**(U.S. Dollars)**

(h) *Stock Issued in Exchange for Services.*

The Company's common stock issued in exchange for services is valued at an estimated fair market value based upon trading prices of the Company's common stock on the dates of the stock transactions. The corresponding expense of the services rendered is recognized over the period that the services are performed.

(i) *Stock-based Compensation.*

The Company recognizes compensation expense for all share-based payments in accordance with ASC 718, *Compensation - Stock Compensation*. Under the fair value recognition provisions of ASC 718, the Company recognizes share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award.

The fair value at grant date of stock options is estimated using the Black-Scholes-Merton option-pricing model. Compensation expense is recognized on a straight-line basis over the stock option vesting period based on the estimated number of stock options that are expected to vest.

(j) *Comprehensive Income.*

Other comprehensive income refers to revenues, expenses, gains and losses that under generally accepted accounting principles are included in comprehensive income, but are excluded from net income as these amounts are recorded directly as an adjustment to stockholders equity. The Company's other comprehensive income is primarily comprised of unrealized foreign exchange gains and losses.

(k) *Income (loss) Per Share.*

Basic earnings (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding in the period. Diluted earnings (loss) per share are calculated giving effect to the potential dilution of the exercise of options and warrants.

(l) *Use of Estimates.*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and would impact the results of operations and cash flows.

(m) *Financial Instruments.*

The fair market value of the Company's financial instruments comprising cash and cash equivalents, accounts receivable, long term deposits and accounts payable were estimated to approximate their carrying values due to immediate or short-term maturity of these financial instruments. The Company maintains cash balances at financial institutions which at times, exceed federally insured amounts. The Company has not experienced any material losses in such accounts.

**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Period Ended September 30, 2010**  
**(U.S. Dollars)**

The Company is exposed to foreign exchange and interest rate risk to the extent that market value rate fluctuations materially differ from financial assets and liabilities, subject to fixed long-term rates.

(n) *Fair Value of Financial Instruments*

In August 2009, an update was made to *Fair Value Measurements and Disclosures - Measuring Liabilities at Fair Value*. This update permits entities to measure the fair value of liabilities, in circumstances in which a quoted price in an active market for an identical liability is not available, using a valuation technique that uses a quoted price of an identical liability when traded as an asset, quoted prices for similar liabilities or similar liabilities when traded as assets or the income or market approach that is consistent with the principles of *Fair Value Measurements and Disclosures*. Effective upon issuance, the Company has adopted this guidance with no material impact to the Company's consolidated financial statements.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs described below, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The fair values of cash and cash equivalents, accounts receivable, long term deposits and accounts payable for all periods presented approximate their respective carrying amounts due to the short term nature of these financial instruments. The fair values of long term debt approximate their carrying amounts as they bear market rates of interest.

(o) *Contingencies*

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought.

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If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potential material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the guarantees would be disclosed.

(p) *Income Taxes*

Federal, state and foreign income taxes are computed at current tax rates, less tax credits. Provisions for income taxes include amounts that are currently payable, plus changes in deferred income tax assets and liabilities. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced by a valuation allowance so that the assets are recognized only to the extent that when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will be realized.

(q) *Risk Management*

The Company's credit risk is primarily attributable to its accounts receivable. The amounts presented in the accompanying consolidated balance sheets are net of allowances for doubtful accounts, estimated by the Company's management based on prior experience and the current economic environment. The Company is exposed to credit-related losses in the event of non-performance by counterparties to the financial instruments. Credit exposure is minimized by dealing with only credit worthy counterparties. Accounts receivable for the three primary customers totals \$1,184,245 (59%) as at September 30, 2010 (2009 - \$1,030,960 or 67%).

The credit risk on cash and cash equivalents is limited because the Company limits its exposure to credit loss by placing its cash and cash equivalents with major financial institutions.

The Company is not exposed to significant interest rate risk to the extent that long term debt owed to foreign government agencies is subject to a fixed rate of interest.

In order to manage its exposure to foreign exchange risks, the Company is closely monitoring the fluctuations in the foreign currency exchange rates and the impact on the value of cash and cash equivalents, accounts receivable, and accounts payable.



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(r) *Recent Accounting Pronouncements*

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, *Multiple-Deliverable Revenue Arrangement* (ASU 2009-13), which amends Codification Topic 605, *Revenue Recognition*. This update provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. This update also establishes a selling price hierarchy for determining the selling price of a deliverable. ASU 2009-13 is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently evaluating the impact the adoption of the update may have on its consolidated results of operations and financial position.

In June 2009, the FASB issued ASU No. 2009-1 to FASB Codification Topic 105, *Generally Accepted Accounting Principles*, based on SFAS No. 168, *FASB Accounting Guidance Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of SFAS No. 162*. This statement establishes that the FASB Codification becomes the single official source of authoritative U.S. GAAP superseding all non-SEC accounting and reporting standards and literature. Only one level of authoritative U.S. GAAP will exist and all other literature will be considered non-authoritative. The FASB Codification became effective for interim and annual periods ending on or after September 15, 2009. The Company adopted the FASB Codification beginning in the fourth quarter of fiscal 2009. Given that the FASB Codification does not change U.S. GAAP, this statement had no impact on the Company's consolidated financial condition or results of operations. Where possible, previously disclosed FASB references have been replaced with FASB Codification references.

In June 2009, an update was made to ASC 810, *Consolidation*. This update amends previous guidance to require the Company to perform an analysis to determine whether its variable interests give it a controlling financial interest in a variable interest entity. The update is effective for annual periods beginning after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The Company is currently evaluating the impact the adoption of the update may have on its consolidated results of operations and financial position.

In May 2009, the FASB issued guidance which is included in FASB Codification Topic 855, *Subsequent Events*, (ASC 855). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. The Company has evaluated subsequent events through September 30, 2010 for appropriate accounting and disclosure in accordance with this standard.

In April 2009, the FASB issued guidance which is included in FASB Codification Topic 320, *Investments – Debt and Equity Securities*, (ASC 320). ASC 320 amended the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The Company's implementation of this standard on May 1, 2009 did not have a significant impact on its consolidated statements of operations and financial position.

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**3. ACCOUNTS RECEIVABLE**

|                                  | <u>2010</u>         | <u>2009</u>         |
|----------------------------------|---------------------|---------------------|
| Accounts receivable              | \$ 2,006,199        | \$ 1,552,723        |
| Allowances for doubtful accounts | (13,038)            | (8,359)             |
|                                  | <u>\$ 1,993,161</u> | <u>\$ 1,544,364</u> |

**4. INVENTORIES**

|                  | <u>2010</u>         | <u>2009</u>         |
|------------------|---------------------|---------------------|
| Completed goods  | \$ 1,373,884        | \$ 1,670,485        |
| Work in progress | 26,843              | 96,935              |
| Raw materials    | 1,146,610           | 1,028,887           |
|                  | <u>\$ 2,547,337</u> | <u>\$ 2,796,307</u> |

**5. PROPERTY, PLANT & EQUIPMENT**

|                                        | <u>September 30, 2010</u> |                                     |                     |
|----------------------------------------|---------------------------|-------------------------------------|---------------------|
|                                        | <u>Cost</u>               | <u>Accumulated<br/>Depreciation</u> | <u>Net</u>          |
| Buildings                              | \$ 3,216,859              | \$ 1,521,120                        | \$ 1,695,739        |
| Plant under construction and equipment | 4,576,371                 |                                     | 4,576,371           |
| Computer hardware                      | 95,730                    | 68,665                              | 27,065              |
| Furniture and fixtures                 | 26,572                    | 17,540                              | 9,032               |
| Office equipment                       | 23,153                    | 18,117                              | 5,036               |
| Manufacturing equipment                | 2,379,488                 | 1,724,160                           | 655,328             |
| Trailer                                | 27,127                    | 15,601                              | 11,526              |
| Technology                             | 132,758                   |                                     | 132,758             |
| Trade show booth                       | 8,444                     | 7,510                               | 934                 |
| Truck                                  | 11,555                    | 6,227                               | 5,328               |
| Land                                   | 469,292                   |                                     | 469,292             |
|                                        | <u>\$ 10,967,349</u>      | <u>3,378,940</u>                    | <u>\$ 7,588,409</u> |

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|                                        | December 31, 2009 |                             |              |
|----------------------------------------|-------------------|-----------------------------|--------------|
|                                        | Cost              | Accumulated<br>Depreciation | Net          |
| Buildings                              | \$ 3,168,247      | \$ 1,385,381                | \$ 1,782,866 |
| Plant under construction and equipment | 4,190,272         |                             | 4,190,272    |
| Computer hardware                      | 83,725            | 63,022                      | 20,703       |
| Furniture and fixtures                 | 26,170            | 15,693                      | 10,477       |
| Office equipment                       | 21,973            | 16,929                      | 5,044        |
| Manufacturing equipment                | 2,297,561         | 1,608,101                   | 689,460      |
| Trailer                                | 26,560            | 12,000                      | 14,560       |
| Technology                             | 129,985           |                             | 129,985      |
| Trade show booth                       | 8,268             | 7,088                       | 1,180        |
| Truck                                  | 11,313            | 4,582                       | 6,731        |
| Land                                   | 463,648           |                             | 463,648      |
|                                        | \$ 10,427,722     | \$ 3,112,796                | \$ 7,314,926 |

Amount of depreciation expense for the nine months ended September 30, 2010: \$269,209 (2009: \$301,595)

Capitalized costs pertaining to our new plant in Taber, Alberta are classified as Plant under construction and equipment and include contracted costs and supplies, but do not include capitalized interest costs. The Company will not begin depreciating the plant and equipment until it becomes operational.

The following carrying amount of capital assets held by Flexible Solutions Ltd. serves as collateral for the AFSC loan:

|                         |            |
|-------------------------|------------|
| Land                    | \$ 270,199 |
| Building                | 1,024,457  |
| Building improvements   | 1,047,078  |
| Manufacturing equipment | 2,576,925  |
| Trailer                 | 11,525     |
| Truck                   | 5,328      |
| Trade show booth        | 934        |
| Technology              | 132,759    |

**6. PATENTS**

Patents are amortized over their legal life of 17 years.

Patents with a cost of, \$76,942 are not subject to amortization as of September 30, 2010, since the patents are still in the process of being approved.

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| September 30, 2010 |            |                             |            |
|--------------------|------------|-----------------------------|------------|
|                    | Cost       | Accumulated<br>Amortization | Net        |
| Patents            | \$ 257,642 | \$ 37,263                   | \$ 220,379 |

| December 31, 2009 |            |                             |            |
|-------------------|------------|-----------------------------|------------|
|                   | Cost       | Accumulated<br>Amortization | Net        |
| Patents           | \$ 252,273 | \$ 27,768                   | \$ 224,505 |

Amount of depreciation for nine months ended September 30, 2010 - \$8,844 (2009 - \$8,995)

Estimated depreciation expense over the next five years is as follows:

|      |           |
|------|-----------|
| 2010 | \$ 11,871 |
| 2011 | 11,871    |
| 2012 | 11,871    |
| 2013 | 11,871    |
| 2014 | 11,871    |

**7. LONG TERM DEPOSITS**

The Company has reclassified certain security deposits to better reflect their long term nature. Long term deposits consist of damage deposits held by landlords and security deposits held by various vendors.

|                    | September<br>30,<br><br>2010 | December<br>31,<br><br>2009 |
|--------------------|------------------------------|-----------------------------|
| Long term deposits | \$ 7,648                     | \$ 7,499                    |

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**8. LONG TERM DEBT**

(a) The Company has received a non-interest bearing loan from the Department of Agriculture and Agri-Food Canada ( AAFC ). Eligible for up to \$1,000,000 Canadian funds, the Company had borrowed \$910,801 in Canadian funds (\$885,116 US) as of September 30, 2010, on an unsecured basis. If the full amount is borrowed, the repayment schedule is as follows:

| <u>Amount Due (in CDN funds)</u> | <u>Payment Due Date</u> |
|----------------------------------|-------------------------|
| \$200,000                        | January 1, 2012         |
| \$200,000                        | January 1, 2013         |
| \$200,000                        | January 1, 2014         |
| \$200,000                        | January 1, 2015         |
| \$200,000                        | January 1, 2016         |

(b) The Company has also received a 5% simple interest loan from Agriculture Financial Services Corp. ( AFSC ). Eligible for up to \$2,000,000 Canadian funds, the Company had borrowed \$1,491,000 in Canadian funds (\$1,394,965 US) as of September 30, 2010. The Company is required to make interest payments until May 1, 2010 and then must pay down the principal in equal payments until May 1, 2014. The Company has pledged its building in Taber, Alberta, as well as equipment, inventory and accounts receivable (see Notes 3 and 5) as collateral, as well as signed a promissory note guaranteeing the amount of the loan.

**Continuity:**

|                                   |              |
|-----------------------------------|--------------|
| Balance at December 31, 2008      | \$ 1,546,836 |
| Add: proceeds from long term debt | 462,155      |
| Effect of exchange rate           | 276,323      |
|                                   | <hr/>        |
| Balance at December 31, 2009      | \$ 2,285,314 |
| Effect of exchange rate           | (5,233)      |
|                                   | <hr/>        |
| Balance at September 30, 2010     | \$ 2,280,081 |
|                                   | <hr/>        |

**Outstanding balance at:**

|                      | <u>2010</u>  | <u>2009</u>  |
|----------------------|--------------|--------------|
| Long term debt AAFC  | \$ 885,116   | \$ 866,627   |
| Long term debt AFSC  | 1,394,965    | 1,418,687    |
|                      | <hr/>        | <hr/>        |
| Long term debt       | \$ 2,280,081 | \$ 2,285,314 |
| Less current portion | (117,639)    | (74,146)     |
|                      | <hr/>        | <hr/>        |
|                      | \$ 2,162,442 | \$ 2,211,168 |
|                      | <hr/>        | <hr/>        |

**9. STOCK OPTIONS**

The Company adopted a stock option plan ( Plan ). The purpose of this Plan is to provide additional incentives to key employees, officers, directors and consultants of the Company and its subsidiaries in order to help attract and retain the best available personnel for positions of

responsibility and otherwise promoting the success of its business activities. The general terms of awards under the option plan are that 100% of the options granted will vest the year following the grant. The maximum term of options granted is 5 years.

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The Company may issue stock options and stock bonuses for shares of its common stock to provide incentives to directors, key employees and other persons who contribute to the success of the Company. The exercise price of all incentive options are issued for not less than fair market value at the date of grant.

The following table summarizes the Company's stock option activity for the years ended December 31, 2008 and, 2009 and the period ended September 30, 2010:

|                             | <u>Number of shares</u> | <u>Exercise price per share</u> | <u>Weighted average exercise price</u> |
|-----------------------------|-------------------------|---------------------------------|----------------------------------------|
| Balance, December 31, 2007  | 1,912,440               | \$ 3.04 - \$4.60                | \$ 3.38                                |
| Granted                     | 203,000                 | \$3.60                          | \$ 3.60                                |
| Cancelled or expired        | (204,740)               | \$ 3.00 - \$4.60                | \$ 3.74                                |
| Balance, December 31, 2008  | 1,910,700               | \$ 3.00 - \$4.55                | \$ 3.38                                |
| Granted                     | 122,000                 | \$2.25                          | \$ 2.25                                |
| Cancelled or expired        | (486,000)               | \$ 3.00 - \$4.55                | \$ 3.44                                |
| Balance, December 31, 2009  | 1,546,700               | \$ 2.25 - \$3.85                | \$ 3.25                                |
| Granted                     | 315,000                 | \$ 1.50 - \$2.25                | \$ 1.87                                |
| Cancelled or expired        | (25,000)                | \$ 1.50 - \$3.85                | \$ 1.97                                |
| Balance, September 30, 2010 | 1,836,700               | \$ 1.50 - \$3.60                | \$ 3.03                                |

The fair value of each option grant is calculated using the following weighted average assumptions:

|                                                | <u>2010</u>   | <u>2009</u> |
|------------------------------------------------|---------------|-------------|
| Expected life - years                          | 5.0           | 5.0         |
| Interest rate                                  | 1.4 - 2.49%   | 1.14%       |
| Volatility                                     | 60%           | 65%         |
| Dividend yield                                 | %             | %           |
| Weighted average fair value of options granted | \$0.29 - 0.70 | \$1.00      |

During the nine months ended September 30, 2010 the Company granted 61,000 options to consultants that resulted in \$15,024 in expenses for the period. During the same period, 254,000 options were granted to employees, resulting in \$45,046 in expenses for the period. Options granted in previous quarters resulted in additional expenses in the amount of \$15,855 for consultants and \$32,613 for employees during the nine months ended September 30, 2010. No stock options were exercised during the nine months ended September 30, 2010.

During the nine months ended September 30, 2009 the Company granted 61,000 options to consultants that resulted in \$46,038 in expenses this quarter. During the same period, 61,000 options were granted to employees, resulting in \$46,038 in expenses. Options granted in previous years resulted in additional expenses in the amount of \$35,674 for consultants and \$71,122 for employees during the nine months ended September 30, 2009. No stock options were exercised during this period.

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**10. WARRANTS**

On April 14, 2005, the Company announced that it had raised \$3,375,000 pursuant to a private placement. The investors in this offering purchased 900,000 shares of the Company's common stock at a per-share price of \$3.75, together with warrants to purchase up to 900,000 additional shares of the Company's common stock. The warrants originally had a 4 year term and were exercisable at a price of \$4.50 per share.

On June 8, 2005, the Company announced that it had raised an additional \$327,750 pursuant to a private placement. An investor purchased 87,400 shares of the Company's common stock at a per share price of \$3.75, together with a warrant to purchase up to 87,400 additional shares of the Company's common stock. The warrants originally had a 4 year term and were exercisable at a price of \$4.50 per share.

In February 2009, the Company amended the warrants granted in 2005 to a per share exercise price of \$4.00 and extended the exercise term until July 31, 2009.

In May 2007 the Company closed a \$3,042,455 private placement with institutional investors. The Company sold 936,140 units at a price of \$3.25 per unit. Each unit consisted of one share of common stock and one-half warrant with a three year term and an exercise price of \$4.50 per share. The Company also issued 21,970 warrants with the same terms for investment banking services related to this transaction.

In February 2010, the Company amended the warrants granted in 2007 to a per share exercise price of \$3.00 and extended the exercise term until December 31, 2010.

The following table summarizes the Company's warrant activity for the three years ended December 31, 2009 (no subsequent activity):

|                                                   | Number of shares | Exercise price<br>per share | Weighted average<br>exercise price |
|---------------------------------------------------|------------------|-----------------------------|------------------------------------|
| Balance, December 31, 2007 and 2008               | 1,477,440        | \$ 4.50                     | \$ 4.50                            |
| Granted                                           |                  |                             |                                    |
| Exercised                                         |                  |                             |                                    |
| Cancelled/Expired                                 | 987,400          | \$ 4.50                     | \$ 4.50                            |
| Balance, December 31, 2009 and September 30, 2010 | 490,040          | \$ 3.00                     | \$ 3.00                            |

**11. CAPITAL STOCK.**

The Company did not issue any shares of its common stock during the nine months ended September 30, 2009. The Company cancelled 100,000 shares during the nine months ended September 30, 2009. See Note 14.

The Company did not issue or cancel any shares of its common stock during the nine months ended September 30, 2010.



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**12. SEGMENTED, SIGNIFICANT CUSTOMER INFORMATION AND ECONOMIC DEPENDENCY.**

The Company operates in two segments:

(a) Development and marketing of two lines of energy and water conservation products (as shown under the column heading EWCP below), which consists of a (i) liquid swimming pool blanket which saves energy and water by inhibiting evaporation from the pool surface, and (ii) food-safe powdered form of the active ingredient within the liquid blanket and which is designed to be used in still or slow moving drinking water sources.

(b) Manufacture of biodegradable polymers ( BCPA s ) used by the petroleum, chemical, utility and mining industries to prevent corrosion and scaling in water piping. This product can also be used in detergents to increase biodegradability and in agriculture to increase crop yields by enhancing fertilizer uptake.

The accounting policies of the segments are the same as those described in Note 2, *Significant Accounting Policies*. The Company evaluates performance based on profit or loss from operations before income taxes, not including nonrecurring gains and losses and foreign exchange gains and losses.

The Company s reportable segments are strategic business units that offer different, but synergistic products and services. They are managed separately because each business requires different technology and marketing strategies.

Nine months ended September 30, 2010:

|                                 | <u>EWCP</u> | <u>BPCA</u>  | <u>Total</u> |
|---------------------------------|-------------|--------------|--------------|
| Revenue                         | \$ 814,613  | \$ 8,080,706 | \$ 8,895,319 |
| Interest revenue                |             |              |              |
| Interest expense                | 53,142      | 1,265        | 54,407       |
| Depreciation and amortization   | 34,631      | 234,578      | 269,209      |
| Segment profit (loss)           | (1,208,559) | 1,435,225    | 226,666      |
| Segment assets                  | 5,315,657   | 2,493,131    | 7,808,788    |
| Expenditures for segment assets | 296,639     | 131,959      | 428,598      |

Nine months ended September 30, 2009:

|                                 | <u>EWCP</u> | <u>BPCA</u>  | <u>Total</u> |
|---------------------------------|-------------|--------------|--------------|
| Revenue                         | \$ 686,811  | \$ 6,694,490 | \$ 7,381,301 |
| Interest revenue                |             |              |              |
| Interest expense                | 43,695      | 3,736        | 47,431       |
| Depreciation and amortization   | 39,712      | 261,883      | 301,595      |
| Segment profit (loss)           | (1,130,656) | 620,902      | (509,754)    |
| Segment assets                  | 4,701,236   | 2,672,026    | 7,373,262    |
| Expenditures for segment assets | 1,564,173   | 24,258       | 1,588,431    |

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The sales generated in the United States and Canada for the nine months ended September 30, 2010 and 2009 are as follows:

|                          | <u>2010</u>         | <u>2009</u>         |
|--------------------------|---------------------|---------------------|
| Canada                   | \$ 292,226          | \$ 276,488          |
| United States and abroad | 8,603,093           | 7,104,831           |
| <b>Total</b>             | <b>\$ 8,895,319</b> | <b>\$ 7,381,301</b> |

The Company's long-lived assets (property, equipment, leaseholds and patents) are located in Canada and the United States as follows:

|               | <u>2010</u>         | <u>2009</u>         |
|---------------|---------------------|---------------------|
| Canada        | \$ 5,315,657        | \$ 4,943,238        |
| United States | 2,493,131           | 2,596,193           |
| <b>Total</b>  | <b>\$ 7,808,788</b> | <b>\$ 7,539,431</b> |

Three customers accounted for \$5,358,184 (60%) of sales made in the period (2009 - \$4,559,009 or 62%).

**13. COMMITMENTS.**

The Company is committed to minimum rental payments for property and premises aggregating approximately \$322,370 over the term of three leases, the last expiring on June 30, 2014.

Commitments in each of the next five years are approximately as follows:

|      |           |
|------|-----------|
| 2010 | \$ 35,466 |
| 2011 | 89,480    |
| 2012 | 74,023    |
| 2013 | 77,026    |
| 2014 | 46,375    |

**14. CONTINGENCIES.**

On May 1, 2003, the Company filed a lawsuit in the Supreme Court of British Columbia, Canada, against John Wells and Equity Trust, S.A. seeking the return of 100,000 shares of its common stock and the repayment of a \$25,000 loan which were provided to the defendants for investment banking services. The services were not performed and in the proceedings the Company sought the return of the shares and the repayment of the loan. On the date of issuance, the transaction was recorded as shares issued for services at a fair market value of \$0.80 per share. On April 30, 2009 the Supreme Court of British Columbia ruled in favor of the Company and ordered Equity Trust S.A. to return the 100,000 shares and repay the loan with interest (\$30,514US). The Company has reversed the expense recorded for the shares in the year ended December 31, 2009.

**15. SUBSEQUENT EVENTS.**

None.

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**16. COMPARATIVE FIGURES.**

Certain of the comparative figures have been reclassified to conform with the current year's presentation.

**Item 2. Management's Discussion and Analysis or Plan of Operation.****Overview**

The Company develops, manufactures and markets specialty chemicals that slow the evaporation of water. The Company also manufactures and markets biodegradable polymers which are used in the oil, gas and agriculture industries.

**Results of Operations**

The Company has two product lines:

Energy and Water Conservation products. The Company's HEAT\$AVR® product is used in swimming pools and spas. The product forms a thin, transparent layer on the water's surface. The transparent layer slows the evaporation of water, allowing the water to retain a higher temperature for a longer period of time and thereby reducing the energy required to maintain the desired temperature of the water. WATER\$AVR®, a modified version of HEAT\$AVR®, can be used in reservoirs, potable water storage tanks, livestock watering ponds, canals, and irrigation ditches.

BCCA products. The second product TPA's (i.e. thermal polyaspartate biopolymers) are biodegradable polymers used by the petroleum, chemical, utility and mining industries to prevent corrosion and scaling in water piping. This product can also be used in detergents to increase biodegradability and in agriculture to increase crop yields by enhancing fertilizer uptake.

The Company's US subsidiary, Nanochem Solutions, Inc has normally generated income and paid income taxes on its profits. However, the Company's Canadian subsidiary, Flexible Solutions Ltd., normally generates losses. The losses of the Company's Canadian subsidiary cannot be used to reduce any taxes payable by the Company's US subsidiary. As a result, and since for financial reporting purposes the operating results of the US and Canadian subsidiaries are consolidated, the income tax expense (benefit) shown in the Company's statements of operations reflects the combined income tax (benefit) of the subsidiaries.

Material changes in the Company's Statement of Operations for the periods presented are discussed below:

Nine Months ended September 30, 2010

| <u>Item</u>        | <u>Increase (I) or<br/>Decrease (D)</u> | <u>Reason</u>                                                   |
|--------------------|-----------------------------------------|-----------------------------------------------------------------|
| Sales:             |                                         |                                                                 |
| EWCP products      | I                                       | Increase in customers' inventories to more normal levels.       |
| BCCA products      | I                                       | Return to more normalized business in 2010 as opposed to 2009.  |
| Gross Profit       | I                                       | Increase in sales.                                              |
| Wages              | I                                       | Increase of employees and annual wage due to increase in sales. |
| Investor relations | I                                       | During the nine months ended September 30, 2009                 |

there as a one time reversal of \$80,000 as shares of the Company's common stock were cancelled by the Supreme Court of British Columbia. See Note 14 to the financial statements included as part of this report for more information.

|             |   |                                                                                                                                                                                                                                                        |
|-------------|---|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Rent        | D | A lease at a former location expired in 2009                                                                                                                                                                                                           |
| Consulting  | D | The granting of stock options to long-term consultants, which vest over a five year period beginning in 2006, resulted in a stock option expense of \$11,325 in the nine months ended September 30, 2010 compared to \$25,481 in the same period 2009. |
| Research    | I | New product development.                                                                                                                                                                                                                               |
| Commissions | I | Increased sales.                                                                                                                                                                                                                                       |
| Utilities   | I | Increased work at the Taber plant has required increased used of energy. Once the facility is operational, these costs will be allocated to overhead.                                                                                                  |

Three months ended September 30, 2010

| <u>Item</u>                            | <u>Increase (I) or<br/>Decrease (D)</u> | <u>Reason</u>                                                                                         |
|----------------------------------------|-----------------------------------------|-------------------------------------------------------------------------------------------------------|
| Sales:<br>BPCA products                | I                                       | Return to more normalized business in 2010 as opposed to 2009 has resulted in an increase in revenue. |
| Gross Profit                           | D                                       | Increased costs, mainly shipping, led to a decrease in gross profit.                                  |
| Wages                                  | I                                       | Increase of employees and annual wage increases.                                                      |
| Rent                                   | D                                       | A lease at a former location expired in 2009 resulting in a decrease in rent expense.                 |
| <b>Capital Resources and Liquidity</b> |                                         |                                                                                                       |

The Company's sources and (uses) of cash for the nine months ended September 30, 2010 and 2009 are shown below:

|                                         | Nine Months<br>Ended September 30 |             |
|-----------------------------------------|-----------------------------------|-------------|
|                                         | 2010                              | 2009        |
| Cash provided by operations             | 189,313                           | 667,742     |
| Construction of plant in Taber, Alberta | (296,639)                         | (1,545,137) |
| Purchases of equipment                  | (131,959)                         | (24,258)    |
| Proceeds from (repayment) of loans      | (53,629)                          | 428,670     |
| Changes in exchange rates               | 16,537                            | 493,962     |
| Other                                   |                                   | (5,125)     |
| Cash on hand at beginning of year       | 276,377                           |             |

In 2007, the Company began construction of a plant in Taber Alberta. The plant will be used to manufacture aspartic acid which is the major component of TPAs. Presently the Company buys its aspartic acid from China where the base raw material is oil. The Company's plant in Taber will use sugar as the base raw material. Although the Company expects that it will still import some aspartic acid from China, using aspartic acid manufactured by its plant from sugar will reduce its raw material costs, reduce price fluctuations generated by oil prices and reduce shipping costs.

The Company expects that the Taber plant will begin commercial production in late 2010 or early 2011 and expects to spend approximately another \$500,000 before commercial production begins.

The Company has sufficient cash resources to meet its future commitments and cash flow requirements for the coming year. As of September 30, 2010 working capital was \$5,796,857 (2009 - \$5,724,264) and the Company has no substantial commitments that require significant outlays of cash over the coming fiscal year.

The Company is committed to minimum rental payments for property and premises aggregating approximately \$322,370 over the term of three leases, the last expiring on June 30, 2014.

Commitments in each of the next five years are approximately as follows:

|      |           |
|------|-----------|
| 2010 | \$ 35,466 |
| 2011 | 89,480    |
| 2012 | 74,023    |
| 2013 | 77,026    |
| 2014 | 46,375    |

Other than as disclosed in this report, the Company does not know of any trends, demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result in, the Company's liquidity increasing or decreasing in any material way.

Other than as disclosed in this report, the Company does not know of any significant changes in its expected sources and uses of cash.

The Company does not have any lines of credit or similar financing arrangements.

See Note 2 to the financial statements included as part of this report for a description of the Company's significant accounting policies and recent accounting pronouncements.

**Item 4. CONTROLS AND PROCEDURES**

Evaluation of Disclosure Controls and Procedures

Under the direction and with the participation of our management, including our Principal Executive and Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2010. We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports with the Securities and Exchange Commission is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations, and that such information is accumulated and communicated to our management, including our principal executive and financial officer, as appropriate, to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide a reasonable level of assurance of reaching desired disclosure control objectives. Based on the evaluation, our Principal Executive and Financial Officer concluded that these disclosure controls and procedures were effective at the reasonable assurance level as of September 30, 2010.

Changes in Internal Control over Financial Reporting

Our management, with the participation of our Principal Executive and Financial Officer, evaluated whether any change in our internal control over financial reporting occurred during the three months ended September 30, 2010. Based on that evaluation, it was concluded that there has been no change in our internal control over financial reporting during the three months ended September 30, 2010 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 6. Exhibits.**

| <u>Number</u> | <u>Description</u>                                                                                                                  |
|---------------|-------------------------------------------------------------------------------------------------------------------------------------|
| 3.1           | Amended and Restated Certificate of Incorporation of the registrant. (1)                                                            |
| 3.2           | Bylaws of the registrant. (1)                                                                                                       |
| 31.1          | Certification of Principal Executive Officer Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*                                   |
| 31.2          | Certification of Principal Financial Officer Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*                                   |
| 32            | Certification of Principal Executive and Financial Officer Pursuant to 18 U.S.C. §1350 and §906 of the Sarbanes-Oxley Act of 2002.* |

\* Filed with this report.

(1) Incorporated by reference to the registrant's Registration Statement on Form 10-SB (SEC File. No. 000-29649) filed February 22, 2000.



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SIGNATURES

In accordance with the requirements of Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

November 11, 2010

**Flexible Solutions International, Inc.**

By:           /s/ Daniel B. O Brien          

Name: Daniel B. O Brien  
Title: President and Chief Executive Officer

By:           /s/ Daniel B. O Brien          

Name: Daniel B. O Brien  
Title: Chief Financial and Accounting Officer

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