

FLEXIBLE SOLUTIONS INTERNATIONAL INC  
Form 10QSB  
November 14, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-QSB**

(Mark one)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

**For the quarterly period ended September 30, 2007.**

Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

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

Commission File Number 000-29649

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**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
(Name of Small Business Issuer as Specified in Its Charter)

**Nevada**  
(State of Incorporation)

**91-1922863**  
(IRS Employer Identification No.)

**615 Discovery Street**  
**Victoria, British Columbia, CANADA**  
(Address of Principal Executive Offices)

**V8T 5G4**  
(Zip Code)

**(250) 477-9969**  
(Issuer's Telephone Number, Including Area Code)

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

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

**APPLICABLE ONLY TO CORPORATE ISSUERS**

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State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: The Company had 14,157,567 shares of Common Stock, par value \$0.001 per share, outstanding as of November 12, 2007.

Transitional Small Business Disclosure Format (check one): Yes  No

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**FORM 10-QSB**

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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 financials 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,” “anticipate” or other 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 rate 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-KSB for the year ended December 31, 2006.

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

**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**At September 30, 2007**  
**(U.S. Dollars)**

|  | September 30,<br>2007<br>(Unaudited) | December 31,<br>2006 |
|--|--------------------------------------|----------------------|
| <b>Assets</b>  |                                      |                      |
| <b>Current</b>   |                                      |                      |
| Cash and cash equivalents                                  | \$ 4,209,185                         | \$ 450,759           |
| Accounts receivable  | 909,861                              | 1,319,575            |
| Inventory  | 2,289,619                            | 1,904,315            |
| Prepaid expenses   | 135,777                              | 124,360              |
|  | 7,544,442                            | 3,799,009            |
| <b>Property, equipment and leaseholds</b>                  | 3,552,938                            | 4,100,553            |
| <b>Patents</b>   | 222,944                              | 169,758              |
| <b>Investment</b>  | 369,000                              | 369,000              |
| <b>Long term deposits</b>                                  | 47,838                               | 47,220               |
|  | \$ 11,737,162                        | \$ 8,485,540         |
| <b>Liabilities</b>   |                                      |                      |
| <b>Current</b>   |                                      |                      |
| Accounts payable and accrued liabilities                   | \$ 239,571                           | \$ 423,030           |
| Deferred revenue   | 9,734                                | 20,559               |
|  | 249,305                              | 443,589              |
| <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                                     |                                      |                      |
| 14,157,567 (2006: 13,058,427) common shares                | 14,158                               | 13,058               |
| <b>Capital in excess of par value</b>                      | 15,953,775                           | 12,370,418           |
| <b>Other comprehensive income</b>                          | 393,107                              | 131,002              |
| <b>Deficit</b>   | (4,873,183)                          | (4,472,527)          |
| <b>Total Stockholders' Equity</b>                          | 11,487,857                           | 8,041,951            |
| <b>Total Liabilities and Stockholders' Equity</b>          | \$ 11,737,162                        | \$ 8,485,540         |

**Commitments, Contingencies and Subsequent events (Notes 12, 13 & 14)**



**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Nine Months Ended September 30, 2007 and 2006**  
**(U.S. Dollars -- Unaudited)**

|  | <b>Nine Months Ended September 30,</b> |              |
|--|--|--------------|
|  | <b>2007</b>                            | <b>2006</b>  |
| <b>Sales</b>   | \$ 5,730,432                           | \$ 6,672,791 |
| <b>Cost of sales</b>                                   | 3,637,590                              | 4,425,543    |
| <b>Gross profit</b>                                    | 2,092,842                              | 2,427,248    |
| <b>Operating expenses</b>                              |  |              |
| Wages  | 800,436                                | 851,744      |
| Administrative salaries and benefits                   | 376,080                                | 475,982      |
| Advertising and promotion                              | 41,771                                 | 35,834       |
| Investor relations and transfer agent fee              | 252,083                                | 146,009      |
| Office and miscellaneous                               | 135,375                                | 127,706      |
| Insurance  | 167,979                                | 161,050      |
| Interest expense                                       | 2,874                                  | 1,974        |
| Rent   | 170,218                                | 176,978      |
| Consulting   | 188,490                                | 290,859      |
| Professional fees                                      | 131,509                                | 212,438      |
| Travel   | 98,063                                 | 78,217       |
| Telecommunications                                     | 27,280                                 | 24,442       |
| Shipping   | 31,301                                 | 33,835       |
| Research   | 78,785                                 | 102,059      |
| Commissions  | 88,533                                 | 130,196      |
| Bad debt expense (recovery)                            | 2,061                                  | 190          |
| Currency exchange                                      | 69,549                                 | 5,277        |
| Utilities  | 14,897                                 | 13,258       |
|  | 2,677,284                              | 2,868,048    |
| <b>Income (loss) before other items and income tax</b> | (584,442)                              | (440,800)    |
| <b>Registration rights penalty</b>                     | -                                      | (326,710)    |
| <b>Other expenses</b>                                  | (15,051)                               | -            |
| <b>Other income</b>                                    | 195,442                                | -            |
| <b>Interest income</b>                                 | 3,396                                  | 2,684        |
| <b>Income (loss) before income tax</b>                 | (400,656)                              | (764,826)    |
| <b>Income tax (recovery)</b>                           | -                                      | (127,079)    |
| <b>Net income (loss)</b>                               | (400,656)                              | (637,747)    |
| <b>Net income (loss) per share (basic and diluted)</b> | \$ (0.03)                              | \$ (0.05)    |
| <b>Weighted average number of common shares</b>        | 13,656,633                             | 12,984,028   |



**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Nine Months Ended September 30, 2007 and 2006**  
**(U.S. Dollars -- Unaudited)**

|  | <b>Nine Months Ended September 30,</b> |                   |
|--|--|-------------------|
|  | <b>2007</b>                            | <b>2006</b>       |
| <b>Operating activities</b>                              |  |                   |
| Net income (loss)  | \$ (400,655)                           | \$ (637,747)      |
| Stock compensation expense                               | 419,975                                | 641,358           |
| Depreciation   | 386,214                                | 447,894           |
|  | 405,534                                | 451,505           |
| Changes in non-cash working capital items:               |  |                   |
| (Increase) Decrease in accounts receivable               | 369,214                                | (484,950)         |
| (Increase) Decrease in inventory                         | (385,304)                              | 356,426           |
| (Increase) Decrease in prepaid expenses                  | (11,417)                               | (32,313)          |
| Increase (Decrease) in accounts payable                  | (142,958)                              | (407,699)         |
| Increase (Decrease) in deferred revenue                  | (10,825)                               | -                 |
| Increase (Decrease) in income taxes                      | -                                      | 28,918            |
| <b>Cash provided by (used in) operating activities</b>   | <b>224,244</b>                         | <b>(88,113)</b>   |
| <b>Investing activities</b>                              |  |                   |
| Long term deposits                                       | (618)                                  | -                 |
| Investments  | -                                      | -                 |
| Loan receivable  | -                                      | (1,157)           |
| Development of patents                                   | (53,186)                               | (10,704)          |
| Acquisition of property and equipment                    | 161,401                                | (41,193)          |
| <b>Cash provided by (used in) investing activities</b>   | <b>107,597</b>                         | <b>(53,054)</b>   |
| <b>Financing activities</b>                              |  |                   |
| Proceeds from issuance of common stock                   | 3,164,481                              | (24,809)          |
| <b>Cash provided by financing activities</b>             | <b>3,164,481</b>                       | <b>(24,809)</b>   |
| Effect of exchange rate changes on cash                  | 262,104                                | 58,109            |
| <b>Inflow (outflow) of cash</b>                          | <b>3,758,426</b>                       | <b>(107,867)</b>  |
| Cash and cash equivalents, beginning                     | 450,759                                | 526,292           |
| <b>Cash and cash equivalents, ending</b>                 | <b>\$ 4,209,185</b>                    | <b>\$ 418,425</b> |
| <b>Supplemental disclosure of cash flow information:</b> |  |                   |
| Registration rights penalty                              | -                                      | (326,710)         |
| Interest paid  | \$ 2,874                               | \$ 2,684          |



**FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Period Ended September 30, 2007**  
**(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, 2006 Annual Report on Form 10-KSB. This quarterly report should be read in conjunction with such 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, 2007, and the consolidated results of operations and the consolidated statements of cash flows for the nine months ended September 30, 2007 and 2006. The results of operations for the nine months ended September 30, 2007 are not necessarily indicative of the results to be expected for the entire fiscal year.

These consolidated financial statements include the accounts of Flexible Solutions International, Inc. (the “Company”), and its wholly-owned subsidiaries Flexible Solutions, Ltd. (“Flexible Ltd.”), NanoChem Solutions Inc., WaterSavr Global Solutions Inc., NanoDetect Technologies Inc. and Seahorse Systems Inc. All inter-company balances and transactions have been eliminated. The parent company was incorporated May 12, 1998 in the State of Nevada and had no operations until June 30, 1998 as described further below.

Flexible Solutions International, Inc. and its subsidiaries develop, manufactures and markets specialty chemicals which slow down the evaporation of water. The companies 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 down 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 (hereinafter 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.

On May 2, 2002, the Company established WaterSavr Global Solutions Inc. through the issuance of 100 shares of common stock from WaterSavr Global Solutions Inc. to the Company.

On February 7, 2005, the Company established Nano Detect Technologies Inc. through the issuance of 1,000 shares of common stock from Nano Detect Technologies Inc. to the Company.

On June 21, 2005, the Company established Seahorse Systems Inc. through the issuance of 1,000 shares of common stock from Seahorse Systems Inc. to the Company.

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Pursuant to a purchase agreement dated May 26, 2004, the Company acquired the assets of Donlar Corporation (“Donlar”) on June 2, 2004 and created a new company, NanoChem Solutions Inc. as the operating entity for such assets. The purchase price of the transaction was \$6,150,000 with consideration being a combination of cash and debt. Under the purchase agreement and as part of the consideration, the Company issued a promissory note bearing interest at 4% to Donlar’s largest creditor to satisfy \$3,150,000 of the purchase price. This note was paid June 2, 2005 and upon payment, all former Donlar assets that were pledged as security were released from their mortgage. The remainder of the consideration given was cash.

The following table summarizes the estimated fair value of the assets acquired at the date of acquisition (at June 9, 2004):

|  |              |
|--|--------------|
| Current assets                                       | \$ 1,126,805 |
| Property and equipment                               | 5,023,195    |
|  | \$ 6,150,000 |
| Acquisition costs assigned to property and equipment | 314,724      |
| Total assets acquired                                | \$ 6,464,724 |

There was no goodwill or other intangible assets except certain patents recorded at nil fair value, acquired as a result of the acquisition. The acquisition costs assigned to property and equipment include all direct costs incurred by the Company to purchase the Donlar assets. These costs include due diligence fees paid to outside parties investigating and identifying the assets, legal costs directly attributable to the purchase of the assets, plus applicable transfer taxes. These costs have been assigned to the individual assets based on their proportional fair values and will be amortized based on the rates associated with the related assets.

## **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 three major classes of inventory: finished goods, works 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. Inventorial 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.

In 2004, the FASB issued SFAS No. 151, “Inventory Costs”, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. This standard requires that such items be recognized as current-period charges. The standard also establishes the concept of “normal capacity” and requires the allocation of fixed production overhead to inventory based on the normal capacity of the production facilities. Any unallocated overhead must be recognized as an expense in the period incurred. This standard is effective for inventory costs incurred starting January 1, 2006. The adoption of this standard did not have a material impact on its financial

position, results of operations or cash flows for 2006 or 2007.

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(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 following methods using the following annual rates:

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

Depreciation is recorded at half for the year the assets are first purchase. 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.

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

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", 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) *Investments.*

Investment in corporations subject to significant influence and investments in partnerships are recorded using the equity method of accounting. On this basis, the Company's share of income and losses of the corporations and partnerships is included in earnings and the Company's investment therein adjusted by a like amount. Dividends received from these entities reduce the investment accounts. Portfolio investments not subject to significant influence are recorded using the cost method.

The fair value of a cost method investment is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment.

The Company currently does not have any investments that require use of the equity method of accounting.

(g) *Foreign Currency.*

The functional currency of one of the 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 Company's functional currency, Canadian Dollars, into the reporting currency, U.S. Dollars, are excluded from the determination of 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 the operating loss if realized during the year and in comprehensive income if they remain unrealized at the end of the year.

(h) *Revenue Recognition.*

Revenue from product sales is recognized at the time the product is shipped since title and risk of loss is 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 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.

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

The valuation of the Company's common stock issued in exchange for services is valued at an estimated fair market value as determined by officers and directors of the Company 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.

(j) *Stock-based Compensation.*

In December 2004, the Financial Accounting Standards Board ("FASB") issued revised SFAS No. 123(R), *Share-Based Payment*, which replaces SFAS No. 123, "*Accounting for Stock-Based Compensation*", which superseded APB Opinion No. 25, "*Accounting for Stock Issued to Employees*". FAS No. 123(R) requires the cost of all share-based payment transactions to be recognized in an entity's financial statements, establishes fair value as the measurement objective and requires entities to apply a fair-value-based measurement method in accounting for share-based payment transactions. SFAS No. 123(R) applies to all awards granted, modified, repurchased or cancelled after July 1, 2005, and unvested portions of previously issued and outstanding awards. The Company adopted this statement for its first quarter starting January 1, 2006 and will continue to evaluate the impact of adopting this statement.

Prior to 2006, the Company adopted the disclosure provisions of SFAS No. 123 for stock options granted to employees and directors. The Company disclosed on a supplemental basis, the pro-forma effect of accounting for stock options awarded to employees and directors, as if the fair value based method had been applied, using the Black-Scholes option-pricing model. The Company has always recognized the fair value of options granted to consultants.



(k) *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.

(l) *Income (Loss) Per Share.*

Income (loss) per share is calculated by dividing net income (loss) by the weighted average number of shares outstanding. Diluted loss per share is computed by giving effect to all potential dilutive options that were outstanding during the year. For the periods ended June 30, 2007, 2006 and 2005, all outstanding options were anti-dilutive.

(m) *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.

(n) *Financial Instruments.*

The fair market value of the Company's financial instruments comprising cash, short-term investment, accounts receivable, income tax recoverable, loan receivable, accounts payable and accrued liabilities and amounts due to shareholders 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.

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.

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 four primary customers totals \$648,538 (68%) as at September 30, 2007 (2006 - \$757,828 or 61%).

(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 therein.

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 potentially 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.

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

**3. Inventories**

|                   | 2007 |           | 2006 |           |
|-------------------|------|-----------|------|-----------|
| Completed goods   | \$   | 1,455,191 | \$   | 970,780   |
| Works in progress |      | 230,082   |      | 397,995   |
| Raw materials     |      | 604,346   |      | 535,540   |
|                   | \$   | 2,289,619 | \$   | 1,904,315 |

**4. Property, Plant & equipment**

|                         | 2007 |           | Accumulated  |           | 2007 |           |
|-------------------------|------|-----------|--------------|-----------|------|-----------|
|                         | Cost |           | Depreciation |           | Net  |           |
| Buildings               | \$   | 3,145,010 | \$           | 906,215   | \$   | 2,238,795 |
| Computer hardware       |      | 69,644    |              | 45,143    |      | 24,501    |
| Furniture and fixtures  |      | 20,797    |              | 11,336    |      | 9,461     |
| Office equipment        |      | 32,593    |              | 21,193    |      | 11,400    |
| Manufacturing equipment |      | 2,266,187 |              | 1,211,112 |      | 1,055,075 |
| Trailer                 |      | 2,308     |              | 1,787     |      | 521       |
| Leasehold improvements  |      | 45,814    |              | 34,510    |      | 11,304    |
| Trade show booth        |      | 8,644     |              | 5,856     |      | 2,788     |
| Land                    |      | 199,093   |              | —         |      | 199,093   |
|                         | \$   | 5,790,090 | \$           | 2,237,152 | \$   | 3,552,938 |

|                         | 2006 |           | Accumulated  |           | 2006 |           |
|-------------------------|------|-----------|--------------|-----------|------|-----------|
|                         | Cost |           | Depreciation |           | Net  |           |
| Buildings               | \$   | 3,144,259 | \$           | 724,752   | \$   | 2,419,507 |
| Computer hardware       |      | 60,576    |              | 34,200    |      | 26,376    |
| Furniture and fixtures  |      | 18,576    |              | 8,608     |      | 9,968     |
| Office equipment        |      | 29,533    |              | 17,488    |      | 12,045    |
| Manufacturing equipment |      | 2,207,781 |              | 990,959   |      | 1,216,822 |
| Trailer                 |      | 1,991     |              | 1,411     |      | 580       |
| Leasehold improvements  |      | 39,517    |              | 25,551    |      | 13,966    |
| Trade show booth        |      | 7,456     |              | 4,353     |      | 3,103     |
| Land                    |      | 398,186   |              | —         |      | 398,186   |
|                         | \$   | 5,907,875 | \$           | 1,807,322 | \$   | 4,100,553 |

**5. Patents**

In fiscal 2005, the Company started the patent process for additional WATER\$AVR® products. Patents associated with these costs were granted in 2006 and they have been amortized over their legal life of 17 years.

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Of the patents costs listed below, \$73,828 are not subject to amortization as of yet, as the patents are still in the process of being approved.

|         | 2007<br>Cost | Accumulated<br>Amortization | 2007<br>Net |
|---------|--------------|-----------------------------|-------------|
| Patents | \$ 233,692   | \$ 10,748                   | \$ 222,944  |

|         | 2006<br>Cost | Accumulated<br>Amortization | 2006<br>Net |
|---------|--------------|-----------------------------|-------------|
| Patents | \$ 172,938   | \$ 3,180                    | \$ 169,758  |

**6. Investments**

|   | 2007       | 2006       |
|---|------------|------------|
| Tatko Inc.                                      | \$ 271,000 | \$ 271,000 |
| Air-Water Interface Delivery and Detection Inc. | 98,000     | 98,000     |
|   | \$ 369,000 | \$ 369,000 |

On May 31, 2003, the Company acquired an option to purchase a 20% interest in the outstanding shares of Tatko Inc. ("Tatko") for consideration of the issuance of 100,000 shares of the Company's common stock. The option to purchase the shares of Tatko expires on May 31, 2008. The cost of the investment has been accounted for based on the fair market value of the Company's common stock on May 31, 2003. For further information on this option, see Contingencies (Note 13) below.

In 2005, NanoDetect purchased 32.7 shares of equity in Air Water Interface Delivery and Detection Inc. ("AWD") for a total cost of \$98,000. This investment represents only 3.3% of the issued and outstanding shares of AWD and, accordingly, will be accounted for under the cost method.

**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.

|                    | 2007      | 2006      |
|--------------------|-----------|-----------|
| Long term deposits | \$ 47,838 | \$ 47,220 |

**8. 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 the business activities. It is intended that options issued under this Plan constitute non-qualified stock options. 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, 2005 and 2006 and the period ended September 30, 2007:

|                             | Number of shares | Exercise price<br>per share | Weighted average<br>exercise price |
|-----------------------------|------------------|-----------------------------|------------------------------------|
| Balance, December 31, 2004  | 1,241,740        | \$ 1.00 - \$4.60            | \$ 2.87                            |
| Granted                     | 30,000           | \$ 3.58 - \$4.40            | \$ 4.17                            |
| Exercised                   | (162,000)        | \$ 1.40                     | \$ 1.40                            |
| Cancelled or expired        | (49,000)         | \$ 3.00 - \$4.25            | \$ 3.52                            |
| Balance, December 31, 2005  | 1,060,740        | \$ 1.40 - \$4.60            | \$ 3.44                            |
| Granted                     | 1,191,000        | \$ 3.25 - \$3.60            | \$ 3.25                            |
| Exercised                   | (46,000)         | \$ 1.40                     | \$ 1.40                            |
| Cancelled or expired        | (79,000)         | \$ 1.40 - \$4.25            | \$ 2.46                            |
| Balance, December 31, 2006  | 2,126,740        | \$ 1.40 - 4.55              | \$ 3.44                            |
| Granted                     | 235,700          | \$ 1.50 - 3.60              | \$ 2.35                            |
| Exercised                   | (163,000)        | \$ 1.50 - 3.25              | \$ 1.77                            |
| Cancelled or expired        | (124,000)        | \$ 3.00 - 4.40              | \$ 3.59                            |
| Balance, September 30, 2007 | 2,075,440        | \$ 3.00 - 4.55              | \$ 3.46                            |

In December 2004, the Financial Accounting Standards Board ("FASB") issued revised FAS No. 123(R), *Share-Based Payment*, which replaces FAS No. 123, *Accounting for Stock-Based Compensation*, which superseded APB Opinion No. 25, *Accounting for Stock Issued to Employees*. FAS No. 123(R) requires the cost of all share-based payment transactions to be recognized in an entity's financial statements, establishes fair value as the measurement objective and requires entities to apply a fair-value-based measurement method in accounting for share-based payment transactions. FAS No. 123(R) applies to all awards granted, modified, repurchased or cancelled after July 1, 2005, and unvested portions of previously issued and outstanding awards. The Company adopted this statement for its first quarter starting January 1, 2006 and will continue to evaluate the impact of adopting this statement.

Prior to 2006, the Company applied APB Opinion No. 25 and related interpretations in accounting for stock options granted to its employees and, accordingly, stock compensation expense of nil was recognized as wages expense in 2005 and 2004.

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

|  | 2007    | 2006    |
|--|---------|---------|
| Expected life – years                          | 5.0     | 5.0     |
| Interest rate                                  | 4.69%   | 3.85%   |
| Volatility                                     | 52%     | 52.0%   |
| Dividend yield                                 | —%      | —%      |
| Weighted average fair value of options granted | \$ 1.35 | \$ 1.69 |

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During the nine months ended September 30, 2007, the Company granted 150,000 stock options to Mr. Grant as a part of the litigation settlement made January 3, 2007. As the options were previously granted and expensed in 2001, no expense was recorded in this period related to this transaction. During the same period, the Company granted 50,700 options to consultants and has applied FAS No. 123(R) using the Black-Scholes option-pricing model, which resulted in additional expenses of \$58,259 during the nine months ended September 30, 2007. Options granted in previous quarters but not yet vested realized expenses of \$140,031 for outsiders and \$229,411 for employees for the nine months ended September 30, 2007. During the three months ended September 30, 2007, the Company granted 35,000 stock options to employees, which resulted in additional expenses of \$5,004 for the period. During the same period, the company cancelled 25,000 stock options written to employees and this resulted in a recoup of \$12,730 in expenses.

During the nine months ended September 30, 2006, the Company granted 440,000 options to purchase common stock to outsiders and has applied FAS No. 123(R) using the Black-Scholes option-pricing model, which resulted in additional expenses of \$104,451 this quarter (recorded as consulting and investor relations expense), for a total of \$263,494 recognized year to date. During the period ended March 31, 2006, the Company granted 675,000 options to employees, resulting in an additional \$125,955 in wages and administrative expenses in each quarter ended March 31, 2006, June 30, 2006 and September 30, 2006.

**9. Warrants**

On April 14, 2005, the Company announced that it had raised \$3,375,000 pursuant to a private placement of up to 1,800,000 shares of its common stock. The investors collectively purchased 900,000 shares of the Company's common stock at a per share purchase price of \$3.75, together with warrants to purchase up to 900,000 additional shares of the Company's common stock. The warrants have a four-year term and are immediately 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 of up to 174,800 shares of its common stock. 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 warrant has a four-year term and is immediately exercisable at a price of \$4.50 per share.

In May 2007 the Company closed a \$3,042,455 private placement with select institutional investors. The terms are 936,140 units with each unit consisting of one share at \$3.25 and one half warrant with a three year term and a strike 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.

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The following table summarizes the Company's warrant option activity for the year period ended September 30, 2007:

|                             | Number of shares | Exercise price<br>per share | Weighted average<br>exercise price |
|-----------------------------|------------------|-----------------------------|------------------------------------|
| Balance, December 31, 2004  | —                | —                           | —                                  |
| Granted                     | 987,400          | \$ 4.50                     | \$ 4.50                            |
| Exercised                   | —                | —                           | —                                  |
| Cancelled                   | —                | —                           | —                                  |
| Balance, December 31, 2005  | 987,400          | \$ 4.50                     | \$ 4.50                            |
| Granted                     | —                | —                           | —                                  |
| Exercised                   | —                | —                           | —                                  |
| Cancelled                   | —                | —                           | —                                  |
| Balance, December 31, 2006  | 987,400          | \$ 4.50                     | \$ 4.50                            |
| Granted                     | 490,040          | \$ 4.50                     | \$ 4.50                            |
| Exercised                   | —                | —                           | —                                  |
| Cancelled                   | —                | —                           | —                                  |
| Balance, September 30, 2007 | 1,477,440        | \$ 4.50                     | \$ 4.50                            |

**10. Capital Stock.**

During the nine months ended September 30, 2007, the Company issued 163,000 shares of common stock upon the exercise of stock options. The strike price varied from \$1.50 – 3.25 per share.

In May 2007 the Company closed a \$3,042,455 private placement with select institutional investors. The terms are 936,140 units with each unit consisting of one share at \$3.25 and one half warrant with a three year term and a strike price of \$4.50 per share. The proceeds will be used to build a biomass conversion facility that will use renewable agriculture crops to produce aspartic acid.

During the quarter ended September 30, 2006, the Company amended a stock option contract issued in 2001. The Company initially issued 20,000 common stock options with an exercise price of \$1.40 to a consultant in exchange for services, which resulted in a consulting expense of \$19,840 in the 2001 financial statements. On September 23, 2006, the Company amended these stock options and instead issued 11,111 common shares to the consultant for past services rendered and no other consideration was received. The market value of the common shares issued was calculated using the then-current trading price of \$3.22 per share and totals \$35,777. A consulting expense of \$15,937, which represents the difference between the market value of the shares issued and the expense recognized in 2001, was recognized in the financial statements.

During the quarter ended June 30, 2006, the Company issued 6,000 shares of common stock at \$1.40 per share upon exercise of stock options.

**11. 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.



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(b) Manufacture of biodegradable polymers and chemical additives used within the petroleum, chemical, utility and mining industries to prevent corrosion and scaling in water piping (as shown under the column heading "BPCA" below). These chemical additives are also manufactured for use in laundry and dish detergents, as well as in products to reduce levels of insecticides, herbicides and fungicides.

The Company's traditional operating activities related to the production and sale of its energy conversation product line. Upon acquiring the Donlar assets, the Company formed NanoChem, which was formed as its wholly-owned subsidiary in exchange for the capital contribution necessary to purchase the Donlar assets. The assets the Company acquired from Donlar include domestic and international patents and business processes relating to the production of TPAs and other environmental products and technologies, as well as a manufacturing plant. These assets are currently used by NanoChem for its revenue-producing activities.

The accounting policies of the segments are the same as those described in Note 2 to the Company's consolidated financial statements, *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.

|                                 | EWCP         | BPCA         | Total        |
|---------------------------------|--------------|--------------|--------------|
| Revenue                         | \$ 1,080,729 | \$ 4,649,703 | \$ 5,730,432 |
| Interest revenue                | 2,542        | 854          | 3,396        |
| Interest expense                | 783          | 2,091        | 2,874        |
| Depreciation and amortization   | 41,056       | 345,158      | 386,214      |
| Segment profit (loss)           | (1,155,336)  | 754,680      | (400,656)    |
| Segment assets                  | 194,974      | 3,357,964    | 3,552,938    |
| Expenditures for segment assets | 36,419       | (197,820)    | (161,401)    |

The sales generated in the United States and Canada are as follows:

|                          | 2007         | 2006         |
|--------------------------|--------------|--------------|
| Canada                   | \$ 73,759    | \$ 199,312   |
| United States and abroad | 5,656,673    | 6,473,479    |
| Total                    | \$ 5,730,432 | \$ 6,672,791 |

The Company's long-lived assets are located in Canada and the United States as follows:

|               | 2007         | 2006         |
|---------------|--------------|--------------|
| Canada        | \$ 413,823   | \$ 364,487   |
| United States | 3,362,059    | 3,905,824    |
| Total         | \$ 3,775,882 | \$ 4,270,311 |

Four customers account for \$3,598,777 (63%) of sales made in the nine months ended September 30<sup>th</sup> 2007 (2006 - \$4,278,159 or 64%).

**12. Commitments.**

The Company is committed to minimum rental payments for property and premises aggregating approximately \$416,226 over the term of four leases, the last expiring on December 31, 2011.

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

|      |    |         |
|------|----|---------|
| 2007 | \$ | 68,516  |
| 2008 |    | 184,312 |
| 2009 |    | 129,944 |
| 2010 |    | 16,727  |
| 2011 |    | 16,727  |

**13. 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 the Company's common stock and the repayment of a \$25,000 loan, which were provided to defendants for investment banking services consisting of securing a \$5 million loan and a \$25 million stock offering. Such services were not performed and in the proceeding the Company seeks return of such shares after defendant's failure to both return the shares voluntarily and repay the note. On May 7, 2003, the Company obtained an injunction freezing the transfer of the shares. On May 24, 2004, there was a hearing on defendant's motion to set aside the injunction, which motion was denied by the trial court on May 29, 2004. On the date of issuance, the share transaction was recorded as shares issued for services at fair market value, a value of \$0.80 per share. No amounts have been recorded as receivable in the Company's consolidated financial statements as the outcome of this claim is not determinable.

On July 23, 2004, the Company filed a breach of contract suit in the Circuit Court of Cook County, Illinois against Tatko. The action arises out of a joint product development agreement entered into between the Company and Tatko in which the Company agreed to invest \$10,000 toward the product development venture and granted to Tatko 100,000 shares of the Company's restricted common stock. In return, Tatko granted the Company a five-year option to purchase 20% of Tatko's outstanding capital stock. Tatko has since refused to collaborate on the agreement and the Company seeks declaratory relief stating that Tatko is not entitled to the 100,000 shares of the Company's restricted common stock. The litigation is still pending at this time.

In addition, Tatko filed its own suit on September 24, 2004 in the Circuit Court of Cook County, Illinois seeking declaratory relief of its entitlement to the Company's restricted common stock. On May 23, 2005, the Tatko suit was dismissed with prejudice by the Circuit Court.

No amounts have been recorded as receivable in the Company's consolidated financial statements and no amount has been accrued as a loss as the outcome of the claim against Tatko is not determinable.

**14. Subsequent Events.**

There have been no subsequent events.

**15. 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**

Flexible Solutions International, Inc. ("we," "us," and "our") develops, manufactures and markets specialty chemicals that slow the evaporation of water. Our initial 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. Using the same technology, WATER\$AVR®, is marketed for water conservation in irrigation canals, aquaculture, and reservoirs where its use slows water loss due to evaporation. We also manufacture and market products for use in the oilfields to reduce scale and corrosion in many 'topside' water systems and in the agriculture industry to reduce fertilizer crystallization before, during and after application.

**Results of Operations**

Material changes in our Statement of Operations for the periods presented are discussed below:

Nine Months Ended September 30, 2007

| <b>Item</b>                               | <b>Increase (I) or<br/>Decrease (D)</b> | <b>Reason</b>   |
|---|---|---|
| Sales                                     | D                                       | Maintenance shutdowns in the oil extraction industry during Q3, 2007 had a comparative year-over-year effect. It is understood that shutdowns did not occur in 2006 because high oil prices encouraged the oil companies to continue production.                    |
| Administrative salaries and benefits      | D                                       | Five year stock option plans granted to several long term employees in 2006 resulted in higher expenses in 2006. Granting of stock options plans resulted in an expense of \$153,451 in first nine months of 2007 as compared to \$277,494 in the same period 2006. |
| Investor relations and transfer agent fee | I                                       | Increase in external investor relations and transfer agent fees as well as options granted in relation to the private placement in May 2007 increased our investor relations costs.   |
| Consulting                                | D                                       | The granting of stock options to long term consultants in 2006 resulted in a stock option expense of \$188,890 in first quarter 2006 as compared to \$108,747 in the same period 2007.  |
| Professional fees                         | D                                       | We experienced reduced professional fees after the conclusion of two lawsuits in December 2006 and January 2007.  |
| Travel                                    | I                                       | Increased international sales required more travel.   |
| Commissions                               | D                                       | Decreased sales resulted in lower commissions.  |
| Other Income                              | I                                       | We sold land which was not needed for our operations which resulted in a one time gain of \$195,442.  |

**Capital Resources and Liquidity**

The sources and uses of funds are directly obtainable from our Consolidated Statement of Cash Flows found on Page 3 of this document.

We have sufficient cash resources to meet our future commitments and cash flow requirements for the coming year. As of September 30, 2007 working capital was \$7,295,137 (2006 - \$3,355,420).

We are committed to minimum rental payments for property and premises aggregating approximately \$416,226 over the term of four leases, the last expiring on December 31, 2011.

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

|      |    |         |
|------|----|---------|
| 2007 | \$ | 68,516  |
| 2008 |    | 184,312 |
| 2009 |    | 129,944 |
| 2010 |    | 16,727  |
| 2011 |    | 16,727  |

We have secured financing for all current capital spending plans, including the announced purchase of land and a building in Alberta. We do not foresee any additional capital requirements for the period ending Dec 31 2007.

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

**Item 3.****Controls and Procedures.***Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports to the Securities and Exchange Commission (“SEC”) 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 officer and principal 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 our desired disclosure control objectives.

As of the end of the period covered by this Quarterly Report, we carried out an evaluation, under the supervision and with the participation of management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us (including our consolidated subsidiaries) that is required to be included in our periodic reports.

**PART II**

**OTHER INFORMATION**

**Item 6.**

**Exhibits.**

**Number Description**

- 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.\*
- 32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. §1350 and §906 of the Sarbanes-Oxley Act of 2002.\*
- 32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. §1350 and §906 of the Sarbanes-Oxley Act of 2002.\*

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\*

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.

**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.

**Flexible Solutions International, Inc.**

Dated: November 14, 2007

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