

FLEXIBLE SOLUTIONS INTERNATIONAL INC
Form 10QSB
May 13, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10QSB

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

For the quarterly period ended MARCH 31, 2005

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

FLEXIBLE SOLUTIONS INTERNATIONAL INC.

(Exact name of small business issuer as specified in its charter)

NEVADA
(State or other jurisdiction of
incorporation or organization)

91-1922863
(IRS Employer Identification No.)

615 Discovery Street, Victoria BC CANADA V8T 5G4

(Address of principal executive offices)

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common
equity, as of the latest practicable date: Common stock \$.001 par value
12,733,916 shares as of April 30, 2005.

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

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

Attached hereto and incorporated herein by reference.

ITEM 2. MANAGER'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS
OF OPERATIONS

The following information contains certain forward-looking statements that
anticipate future trends or events. These statements are based on certain
assumptions that may prove to be erroneous and are subject to certain risks
including but not limited to the risks of increased competition in the Company's
industry and other risks detailed in the Company's Securities and Exchange
Commission filings. Accordingly, actual results may differ, possibly materially,
from the predictions contained herein.

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RESULTS OF OPERATIONS

The following analysis and discussion pertains to the Company's results of operations for the three month period ended March 31st 2005, compared to the results of operations for the three month period ended March 31st 2004, and to changes in the Company's financial condition from December 31st 2004 to March 31st 2005.

THREE MONTHS ENDED MARCH 31ST 2005 AND 2004

For the three months ended March 31st 2005, the Company experienced a profit of \$54,198 as compared to a loss of \$250,861 for the three months ended March 31st 2004. Increased brand recognition and increased sales of our residential pool product, Ecosavr, as well as a full quarter of operations from the NanoChem division has resulted in revenue of \$2,019,581 compared to \$488,110 in the year earlier quarter. Management is extremely satisfied with the effect of the acquisition as the NanoChem division had contributed greatly to sales and cash flow and is starting to replace the capital expended for it. As well, opportunities to synergistically cross sell the products of all divisions have already generated leads to new business and the swimming pool division has discovered ways to help NanoChem increase utilization of the Peru, IL factory while decreasing costs for the Company as a whole. The Company maintained expenditures in the areas of WaterSavr sales and marketing and production equipment development. The major changes that resulted in the large revenue increase were greater sales from our swimming pool division into new overseas markets and increase in sales from the recently acquired NanoChem division. NanoChem sales are much less seasonal than those of our WaterSavr and Flexible Solutions Ltd divisions which should lead to less volatile sales figures in future. Management will attempt to reduce seasonality even further over time.

Operating expenses were \$889,812 for the first quarter, up from \$374,987 for the first quarter of 2004. Flexible Solutions continued its sales and marketing efforts for WaterSavr with the objective of closing the first major sales as soon as possible and with development of advanced production machinery for swimming pool products. The largest real increases were in the areas of wages (\$234,436 versus \$53,289), rent (\$55,806 versus \$21,349), advertising (\$31,271 from \$7,730), and commissions (\$40,925 versus zero). These increases are wholly accounted for by the operating costs of the new division and represent a permanent increase in operating costs related to the new level of sales. The decreases in investor relations (\$24,638 down from \$64,678) and consulting (\$44,252 down from \$74,678) are the result of better cost-control in these areas instituted by management over the past year. Professional fees increased to \$60,843 from \$36,508 in the quarter. This is the result of the company protecting its intellectual property assets vigorously. Note should be made that depreciation increased to \$168,103 from \$9,952 as a result of the depreciable NanoChem assets acquired in June 2004.

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The profit for the quarter was \$54,198, an increase from first quarter last year when the loss was \$250,861. The gain was realized through increased sales in swimming pool products compared to the year earlier quarter augmented by positive operating cash from the NanoChem division.

The profit per share was \$0.00 for the three months ended March 31st, 2005 compared to a loss of \$0.02 for the three months ended March 31st, 2004.

LIQUIDITY AND CAPITAL RESOURCES

The Company has cash on hand of \$495,520 as of the end of March 2005 compared to \$558,795 on December 31st, 2004.

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As of March 31st 2005, the Company had working capital of \$36,925 as compared to working capital of \$(101,121) on December 31st 2004. The increase in working capital is the result of increase sales and profits.

The Company has no external sources of liquidity in the form of credit lines from banks.

Management believes that its available cash will be sufficient to fund the Company's working capital requirements through December 31st 2005. Management further believes that available cash will be sufficient to implement the Company's expansion plans. No investment banking agreements are in place and there is no guarantee that the Company will be able to raise capital in the future should that become necessary.

SUBSEQUENT EVENTS

On April 4th, 2005 the Company announced that it had raised \$3.375 million in capital through a private placement. Participating investors are a select group of investment funds, and the terms are one common share at \$3.75 and a warrant to acquire a further share at \$4.50. The total number of shares subscribed for was limited to 900,000, in order to minimize shareholder dilution while providing sufficient funds to retire the debt remaining from the acquisition of our NanoChem division in June 2004

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS:

The Company does not have any derivative financial instruments as of March 31st 2005. However, the Company is exposed to interest rate risk.

The Company's interest income and expense are most sensitive to changes in the general level of U.S. and Canadian interest rates. In this regard, changes in U.S. and Canadian interest rates affect the interest paid on the Company's cash equivalents as well as the interest paid on debt.

FOREIGN CURRENCY RISK

The Company operates extensively in both Canada and the USA. Therefore, the Company's business and financial condition is sensitive to currency exchange rates or any other restriction imposed on its currency.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

a) The company has been named as defendant in a lawsuit filed in the state of Illinois by a former employee. In November 2003, an ex-employee, Patrick Grant, filed suit against Flexible Solutions International Inc. in Cook County Circuit Court, Cook County, IL, claiming wrongful dismissal and seeking return of options rights or cash. The company believes these allegations are without merit and intends to vigorously defend against them.

b) The company is plaintiff in a lawsuit demanding return of the share certificate of 100,000 shares of stock originally given to the defendant as payment in advance for services. The services for which the advance was given were never performed or given to the company, and the company therefore received no consideration or value for such advance. Return of the share certificate for

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100,000 shares was demanded within ten (10) days, namely August 22, 2001, however, to date remains unreturned. On date of issue, January 4, 2001, the share transaction was recorded as shares issued for services at fair market value, a value of \$0.80 per share.

c) The company has been named the defendant in a lawsuit filed in the Federal Court of Canada as well as the plaintiff in a countersuit in the same court. In July 2004, a former distributor, Sunsolar Energy Technologies, filed suit claiming trademark infringement. The company believes these allegations are without merit and intends to vigorously defend against them.

d) The company is plaintiff in a lawsuit demanding the return of the share certificate of 100,000 shares of stock originally given as payment in advance for services, \$10,000 and undetermined damages resulting from a breach of contract. The suite has been filed in the Circuit Court of Cook County, IL against Tatko Biotech Inc. of Peoria, IL. The services for which the advance was given were never performed or given to the company, and the company therefore received no consideration or value for such advance. The shares were recorded at fair market value less 10%, resulting in an expense of \$271,000 recognized in June 2003.

e) The Company is the plaintiff in a lawsuit filed in the Court of the Queen's Bench of Alberta, where the subsidiary Flexible Solutions Ltd. is inter-provincially registered. The company is seeking undetermined damages resulting from breach of contract against Calgary Diecast Corporation. The contract was never completed and the Company's raw materials remain in the possession Calgary Diecast Corp. On April 25th, 2005, the Court ordered a judgment in favor of Flexible Solutions Ltd. in the amount of \$47,495 and FSL intends to collect using all available means.

ITEM 2. CHANGES IN SECURITIES

None

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

None

ITEM 5. OTHER INFORMATION

None

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ITEM 6.

(b) Reports on Form 8-K

April 14, 2005 - Private placement announcement

April 6, 2005 - 2005 sales prediction

March 24, 2005 - 2004 financials results and distributor announcement

January 10, 2005 - Owens Lakes trial results

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ITEM 14. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of "disclosure controls and procedures" in Rule 13a-14(c). In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Within 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Company completed its evaluation.

SIGNATURES

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

FLEXIBLE SOLUTIONS INTERNATIONAL INC.
(Registrant)

Dated: May 13th 2005

/s/ DAN O'BRIEN
President and Director

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
Consolidated Balance Sheets
March 31, 2004
(U.S. Dollars)

| | March 31 2005 | December 31 2004 |
|---------------------------|------------------|---------------------|
| Assets | | |
| Current | | |
| Cash and cash equivalents | \$ 495,520 | \$ 558,795 |
| Short term investments | - | 559,440 |
| Accounts receivable | 1,111,374 | 501,372 |

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| | | |
|--|-------------|-------------|
| Income tax | 27,799 | 92,963 |
| Loan receivable | 38,652 | 38,570 |
| Inventory | 1,705,890 | 1,416,588 |
| Prepaid expenses | 96,764 | 131,280 |
| | ----- | ----- |
| | 3,475,999 | 3,299,008 |
| Property, equipment and leaseholds | 5,122,341 | 5,250,346 |
| Investment | 325,000 | 271,000 |
| | ----- | ----- |
| | \$8,923,340 | \$8,820,354 |
| | ===== | ===== |
| Liabilities | | |
| Current | | |
| Accounts payable and accrued liabilities | \$ 289,074 | \$ 250,129 |
| Short term loan | 3,150,000 | 3,150,000 |
| | ----- | ----- |
| | 3,439,074 | 3,400,129 |
| | ----- | ----- |
| Stockholders' Equity | | |
| Capital stock | | |
| 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 | | |
| 11,831,916 (2003: 11,794,916) Common shares | 11,832 | 11,832 |
| Capital in excess of par Value | 7,686,820 | 7,663,421 |
| Other comprehensive income | 86,623 | 100,179 |
| Deficit | (2,301,009) | (2,355,207) |
| | ----- | ----- |
| Total Stockholders' Equity | 5,484,266 | 5,420,225 |
| | ----- | ----- |
| Total Liabilities and Stockholders' Equity | \$8,923,340 | \$8,820,354 |
| | ===== | ===== |

Commitments and Contingencies (Notes 14 & 15)

See accompanying notes to financial statements.

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
 Consolidated Statements of Operations
 For Three Months Ended December 31, 2004 and 2003
 (U.S. Dollars)

| | Three Months Ended March 31 | |
|---------------|-----------------------------|------------|
| | 2005 | 2004 |
| | ----- | ----- |
| Sales | \$ 2,019,581 | \$ 488,110 |
| Cost of sales | 1,078,301 | 367,100 |
| | ----- | ----- |

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| | | |
|---|----------------|----------------|
| Gross profit | 941,280 | 121,010 |
| | ----- | ----- |
| Operating Expenses | | |
| Wages | 234,436 | 53,289 |
| Administrative salaries and benefits | 38,005 | 24,847 |
| Advertising and promotion | 31,271 | 7,730 |
| Investor relations and transfer agent fee | 24,638 | 64,678 |
| Office and miscellaneous | 41,457 | 34,590 |
| Insurance | 28,318 | - |
| Interest expense | 37,674 | - |
| Rent | 55,806 | 21,349 |
| Consulting | 44,252 | 74,678 |
| Professional fees | 60,843 | 36,508 |
| Travel | 37,765 | 23,576 |
| Telecommunications | 10,288 | 5,700 |
| Shipping | 12,639 | 3,142 |
| Research | 15,508 | 9,161 |
| Commissions | 40,925 | - |
| Bad debt expense (recovery) | - | - |
| Currency exchange | 718 | 422 |
| Utilities | 7,166 | 5,365 |
| Depreciation | 168,103 | 9,952 |
| | ----- | ----- |
| | 889,812 | 374,987 |
| | ----- | ----- |
| Income (loss) before other items and income tax | 51,468 | (253,977) |
| Interest income | 2,730 | 3,116 |
| | ----- | ----- |
| Income (loss) before income tax | 54,198 | (250,861) |
| Income tax (recovery) | - | - |
| | ----- | ----- |
| Net income (loss) | 54,198 | (250,861) |
| Deficit, beginning | (2,355,207) | (1,097,662) |
| | ----- | ----- |
| Deficit, ending | \$ (2,301,009) | \$ (1,348,523) |
| | ===== | ===== |
| Net income (loss) per share | \$ 0.00 | \$ (0.02) |
| | ===== | ===== |
| Weighted average number of shares | 11,831,916 | 11,807,801 |
| | ===== | ===== |
| See accompanying notes to financial statements. | | |

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
Consolidated Statements of Cash Flows
For The Years Ended December 31, 2004 and 2003
(U.S. Dollars)

| | Three Months March 31 | |
|----------------------|-----------------------|--------------|
| | 2005 | 2004 |
| | ----- | ----- |
| Operating activities | | |
| Net income (loss) | \$ 54,198 | \$ (250,861) |

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| | | |
|--|------------|-------------|
| Stock compensation expense | 23,400 | 66,935 |
| Depreciation | 168,103 | 9,952 |
| | ----- | ----- |
| | 245,701 | (173,974) |
| Changes in non-cash working capital items: | | |
| (Increase) Decrease in accounts receivable | (610,002) | 166,617 |
| (Increase) Decrease in inventory | (289,302) | 29,118 |
| (Increase) Decrease in prepaid expenses | 34,516 | (15,809) |
| Increase (Decrease) in accounts payable | 38,945 | (32,987) |
| Increase (Decrease) in Income taxes | 65,164 | 1,120 |
| Increase (Decrease) in amounts due to shareholders | - | (7,700) |
| | ----- | ----- |
| Cash (used in) operating activities | (514,977) | (33,615) |
| | ----- | ----- |
| Investing activities | | |
| Short-term investments | 559,440 | 1,525,735 |
| Investments | (54,000) | - |
| Loan receivable | (81) | (14,868) |
| Acquisition of property and equipment | (40,099) | (18,338) |
| Incurred acquisition costs | - | (90,912) |
| | ----- | ----- |
| Cash provided by (used in) investing activities | 465,260 | 1,401,617 |
| | ----- | ----- |
| Financing activities | | |
| Proceeds from issuance of common stock | - | 40,500 |
| | ----- | ----- |
| Cash provided by financing activities | - | 40,500 |
| | ----- | ----- |
| Effect of exchange rate changes on cash | (13,559) | 12,348 |
| | ----- | ----- |
| Inflow (outflow) of cash | (63,276) | 1,420,850 |
| Cash and cash equivalents, beginning | 558,795 | 237,080 |
| | ----- | ----- |
| Cash and cash equivalents, ending | \$ 495,520 | \$1,657,930 |
| | ===== | ===== |
| Supplemental disclosure of cash flow information: | | |
| Interest received | \$ 2,730 | \$ 3,116 |
| | ===== | ===== |
| See accompanying notes to financial statements. | | |

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2005 AND 2004
(US DOLLARS)

1. BASIS OF PRESENTATION:

These consolidated financial statements include the accounts of Flexible Solutions International Inc., and its wholly owned subsidiaries Flexible Solutions Ltd., NanoChem Solutions Inc. and WaterSaver Global Solutions Inc. All intercompany balances and transactions have been eliminated. The

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parent company was incorporated May 12, 1998 in the State of Nevada and had no operations until June 30, 1998 as described below.

On June 30, 1998 the company completed the acquisition of 100% of the shares of Flexible Solutions Ltd. The acquisition was effected through the issuance of 7,000,000 shares of common stock by the company with former shareholders of the subsidiary receiving 100% of the total shares then issued and outstanding. The transaction has been accounted for as a reverse-takeover.

Flexible Solutions Ltd. is accounted for as the acquiring party and the surviving entity. As Flexible Solutions Ltd. is the accounting survivor, the consolidated financial statements presented for all periods are those of Flexible Solutions Ltd. The shares issued by Flexible Solutions International Inc. pursuant to the 1998 acquisition have been accounted for as if those shares had been issued upon the organization of Flexible Solutions Ltd.

On May 2, 2002, the company established WaterSaver Global Solutions Inc. through issuance of 100 shares of common stock.

Pursuant to a purchase agreement dated May 26, 2004, the company acquired the assets of Donlar Corporation on June 9, 2004 and created a new company, NanoChem Solutions Inc.

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 the vendor to satisfy \$3,150,000 of the purchase price. This note is due June 2, 2005 and all of the former Donlar assets are used as security.

The following table summarizes the estimated fair value of the assets acquired at the date of acquisition:

As 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 |
| | ===== |

On February 7, 2005 the Company incorporated two new subsidiaries in Nevada. SeaHorse Systems Inc. was incorporated to research new applications of our patented dispensing mechanism currently used for Ecosavr. NanoDetect Technologies Inc. is focusing on ways to use our current technologies to detect pathogens.

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2005 AND 2004
(US DOLLARS)

2. SIGNIFICANT ACCOUNTING POLICIES:

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These consolidated financial statements have been prepared in accordance with generally accepted accounting principles accepted in the United States of America 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) Inventory -

Inventory is valued at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis.

c) Property, Equipment and Leaseholds -

The following assets are recorded at cost and depreciated using the following methods and 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 | Over lease term |

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.

d) Impairment of Long Lived Assets -

The company assesses the recoverability of its long lived assets by determining whether the carrying value of the long lived assets can be recovered over their remaining lives through undiscounted future operating cash flows using a discount rate reflecting the company's average cost of funds. The assessment of the recoverability will be impacted if estimated future operating cash flows are not achieved. For the year ended December 31, 2004, no impairment charges have been recognized.

2. SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

e) Foreign Currency -

The functional currency of Flexible Solutions Ltd. is the Canadian

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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 income and 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 income if realized during the year and in comprehensive income if they remain unrealized at the end of the year.

f) Revenue Recognition -

Revenue from product sales is recognized at the time the product is shipped since title and risk of losses is transferred to purchaser upon delivery to the carrier. Shipments are made F.O.B. shipping point. 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.

g) Stock Issued in Exchange for Services -

The valuation of the common stock issued to non-employees 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.

h) Stock Based Compensation -

The company applies the fair value based method of accounting prescribed by the Statement of Financial Accounting Standards ("SFAS") No. 123 in accounting for stock issued in exchange for services.

i) 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.

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2005 AND 2004

(US DOLLARS)

2. SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

j) Income (Loss) Per Share -

Income (loss) per share is calculated by dividing net income (loss) by the weighted average number of shares outstanding. Diluted income

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(loss) per share is computed by giving effect to all potential dilutive options that were outstanding during the year. For the years ending December 31, 2004, 2003 and 2002 all outstanding options were anti-dilutive.

k) Use of Estimates -

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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.

l) Financial Instruments

i) Fair Values

The fair market value of the financial instruments comprising cash, short-term investment, accounts receivable, loan receivable, accounts payable and accrued liabilities, and short-term loan payable were estimated to approximate their carrying values due to immediate or short-term maturity of these financial instruments.

ii) Foreign Exchange and Interest Rate Risks -

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.

m) Recent Accounting Pronouncements -

- i) In June 2001, the Financial Accounting Standards Board (FASB) issued FAS 142, Goodwill and Other Intangible Assets. Under FAS 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed at least annually for impairment. The amortization provisions of FAS 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill and intangible assets acquired prior to July 1, 2001, the company adopted FAS 142 effective January 1, 2002. Application of the non-amortization provisions of FAS 142 for goodwill did not have any impact on its financial reporting.

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2005 AND 2004
(US DOLLARS)

2. SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

- ii) In October 2001, the FASB issued Statement of Financial Accounting Standards for FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." FAS 144 addresses significant issues relating to the implementation of FAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," and develops a single accounting

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model, based on the framework established in FAS 121 for long-lived assets to be disposed of by sale, whether such assets are or are not deemed to be a business. FAS 144 also modifies the accounting and disclosure rules for discontinued operations. The standard was adopted on January 1, 2002 and did not have any impact on the financial statements.

iii) In November 2001, the FASB issued EITF Issue No. 01-14,. "Income Statement Characterization of Reimbursements Received for "Out of Pocket" Expenses Incurred." This guidance requires companies to recognize the recovery of reimbursable expenses such as travel costs on service contracts as revenue. These costs are not to be netted as a reduction of cost. This guidance was implemented January 1, 2002. The company does not expect this guidance to have a material impact on the financial statements.

3. LOAN RECEIVABLE:

| | 2005 | 2004 |
|----------------------------------|-----------|-----------|
| | ----- | ----- |
| 5% loan receivable due on demand | \$ 38,652 | \$ 38,570 |
| | ===== | ===== |

4. PREPAID EXPENSES:

| | 2005 | 2004 |
|-------------------------------|-----------|------------|
| | ----- | ----- |
| Security deposit and prepaids | \$ 96,764 | \$ 131,280 |
| | ===== | ===== |

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 MARCH 31, 2005 AND 2004
 (US DOLLARS)

5. PROPERTY, EQUIPMENT AND LEASEHOLDS:

| | Cost | Accumulat Amortization | 2005 Net | 2004 Net |
|------------------------|--------------|---------------------------|--------------|--------------|
| | ----- | ----- | ----- | ----- |
| Buildings | \$ 3,144,259 | \$ 231,268 | \$ 2,912,991 | \$ 2,987,046 |
| Computer hardware | 44,370 | 15,854 | 28,516 | 27,511 |
| Furniture and fixtures | 15,609 | 4,238 | 11,371 | 11,515 |
| Office equipment | 28,905 | 11,390 | 17,515 | 18,421 |

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| | | | | |
|-------------------------|--------------|------------|--------------|--------------|
| Manufacturing equipment | 2,139,918 | 411,712 | 1,728,206 | 1,785,858 |
| Trailer | 1,926 | 864 | 1,062 | 1,146 |
| Leasehold improvements | 31,551 | 12,739 | 18,812 | 14,533 |
| Trade Show Booth | 7,212 | 1,530 | 5,682 | 6,130 |
| Land | 398,186 | - | 398,186 | 398,186 |
| | ----- | ----- | ----- | ----- |
| | \$ 5,811,936 | \$ 689,595 | \$ 5,122,341 | \$ 5,250,346 |
| | ===== | ===== | ===== | ===== |

6. INVESTMENT:

| | 2005 | 2004 |
|---|------------|------------|
| | ----- | ----- |
| Tatko Inc. Option to purchase 20% interest in common stock | \$ 271,000 | \$ 271,000 |
| Air Water Interface Delivery & Detection Inc. | 54,000 | - |
| | ----- | ----- |
| | \$ 325,000 | \$ 271,000 |
| | ===== | ===== |

On May 31, 2003 the company acquired an option to purchase a 20% interest in the outstanding shares of Tatko Inc. for consideration of the issuance of 100,000 shares of Flexible Solutions International Inc. common stock. The option to purchase the shares of Taiko Inc. expires on May 31, 2008. The cost of the investment has been accounted for based on the original fair market value of Flexible Solutions International Inc. stock on May 31, 2003.

See Contingencies (Note 11d)

On February 8, 2005, NanoDetect Technologies Inc., a new subsidiary of Flexible Solutions International Inc., purchased 18 shares in Air Water Interface Delivery and Detection Inc. for a total cost of \$54,000. This investment represents only 1.8% of the issued and outstanding shares of AWD, and accordingly will be accounted for under the cost method.

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 MARCH 31, 2005 AND 2004
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7. STOCK OPTIONS:

The company may issue stock options and stock bonuses for common stock of the company 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. There was no stock options issued in the quarter ending March 31, 2005.

The following table summarizes stock option activity for the years ended December 31, 2004 and 2003 and the three months ended March 31, 2005:

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| | Number of shares | Exercise price per share | Weighted average exercise price |
|----------------------------|---------------------|-----------------------------|------------------------------------|
| | ----- | ----- | ----- |
| Balance, December 31, 2002 | 3,686,800 | \$0.25 - \$3.50 | \$3.79 |
| Granted | 256,000 | \$3.60 - \$4.25 | \$3.61 |
| Exercised | (124,000) | \$0.25 - \$2.28 | \$0.48 |
| Expired | (2,107,800) | \$0.25 - \$5.50 | \$4.72 |
| | ----- | ----- | ----- |
| Balance, December 31, 2003 | 1,711,000 | \$1.00 - \$4.25 | \$2.84 |
| Granted | 572,740 | \$3.00 - \$4.60 | \$3.46 |
| Exercised | (37,000) | \$1.00 - \$2.50 | \$1.55 |
| Expired | (5,000) | \$4.25 | \$4.25 |
| Cancelled | (1,000,000) | \$1.50 - \$3.50 | \$2.50 |
| | ----- | ----- | ----- |
| Balance, December 31, 2004 | 1,241,740 | \$1.00 - \$4.60 | \$2.87 |
| | ===== | ===== | ===== |

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

| | 2004 | 2003 | 2002 |
|-----------------------|-------|-------|-------|
| Expected life - years | 5.0 | 5.0 | 5.0 |
| Interest rate | 3.50% | 2.87% | 3.00% |
| Volatility | 49.0% | 49.0% | 72.3% |
| Dividend yield | - % | - % | - % |

During the previous year, the company granted 275,400 (2003 - 205,000) stock options to consultants and have been recognized applying SFAS 123 using the Black-Scholes Option Pricing Model which resulted in additional consulting expense of \$299,345 (2003 - \$122,570). During the year ended December 31, 2003, the company cancelled 2,000,000 stock options to consultants pursuant to the terms of the contract, resulting in a recovery of consulting expense of \$2,480,200.

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
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8. CAPITAL STOCK:

No stock was issued in the quarter ending March 31, 2005.

During the year ended December 31, 2004 the company:

- (i) issued 37,000 shares of common stock at prices ranging from \$1.00 to \$2.50 per share upon exercise of stock options.

During the year ended December 31, 2003 the company:

- (i) issued 100,000 shares of common stock valued at \$271,000 to acquire an option to purchase a 20% interest in Tatko Inc. (Note

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7); and

(ii) issued 124,000 shares of common stock at prices ranging from \$0.25 to \$2.28 per share upon exercise of stock options.

9. 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:

The first line consists of a liquid swimming pool blanket which saves energy and water by storing evaporation from the pool surface. The second line consists of a food safe powdered form of the active ingredient within the liquid blanket and is designed to be used in still or slow moving drinking water sources.

(b) Manufacture of biodegradable polymers and chemical additives:

Biodegradable polymers are used within the petroleum, chemical, utility and mining industries to prevent corrosion and scaling in water piping. Chemical additives are manufactured for use in laundry and dish detergents, as well as in products to reduce levels of insecticides, herbicides and fungicides.

The sales in the United States of America and abroad amounted to 79% (2003 - 28%) . The remainder was earned in Canada.

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

| | 2005 | 2004 |
|---------------|--------------|--------------|
| Canada | \$ 254,579 | \$ 238,807 |
| United States | 4,867,762 | 5,011,539 |
| Total | \$ 5,122,341 | \$ 5,250,346 |

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
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10. COMMITMENTS:

Property and Premises Leases -

The company is committed to minimum rental payments for property and premises aggregating approximately \$360,111 over the term of two leases, the last expiring on June 30, 2009.

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

| | |
|------|-----------|
| 2005 | \$100,718 |
| 2006 | 114,752 |
| 2007 | 55,169 |
| 2008 | 55,654 |

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2009

33,818

11. CONTINGENCIES:

- a) The company has been named as a plaintiff in a lawsuit filed in the state of Illinois by a former employee. In November 2003, an ex-employee, Patrick Grant, filed suit against Flexible Solutions International Inc. in Cook County Circuit Court, Cook County, IL, claiming wrongful dismissal and seeking return of options rights or cash. The company believes these allegations are without merit and intends to vigorously defend against them.
- b) The company is plaintiff in a lawsuit demanding return of the share certificate of 100,000 shares of stock originally given to the defended as payment in advance for services. The services for which the advance was given were never performed or given to the company, and the company therefore received no consideration or value for such advance. Return of the share certificate for 100,000 shares was demanded within ten (10) days, namely August 22, 2001, however, to date remains unreturned.
- On date of issue, January 4, 2001, the share transaction was recorded as shares issued for services at fair market value, a value of \$0.80 per share.
- c) The company has been named the defendant in a lawsuit filed in the Federal Court of Canada as well as the plaintiff in a countersuit in the same court. In July 2004, a former distributor, Sunsolar Energy Technologies, filed suit claiming trademark infringement. The company believes these allegations are without merit and intends to vigorously defend against them.

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
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11. CONTINGENCIES: (CONTINUED)

- d) The company is plaintiff in a lawsuit demanding the return of the share certificate of 100,000 shares of stock originally given as payment in advance for services, \$10,000 and undetermined damages resulting from a breach of contract. The suite has been filed in the Circuit Court of Cook County, IL against Tatko Biotech Inc. of Peoria, IL. The services for which the advance was given were never performed or given to the company, and the company therefore received no consideration or value for such advance.
- The shares were recorded at fair marker value less 10%, resulting in an expense of \$271,000 recognized in June 2003.
- e) The Company is the plaintiff in a lawsuit filed in the Court of the Queen's Bench of Alberta, where the subsidiary Flexible Solutions Ltd. is inter-provincially registered. The company is seeking undetermined

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damages resulting from breach of contract against Calgary Diecast Corporation. The contract was never completed and the Company's raw materials remain in the possession Calgary Diecast Corp.

On April 25th, 2005, the Court ordered a judgment in favor of Flexible Solutions Ltd. in the amount of \$47,495 and intends to collect using all available means.

12. COMPARATIVE FIGURES:

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