

FLEXIBLE SOLUTIONS INTERNATIONAL INC
Form 10-Q
August 15, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from _____ to _____

Commission File Number: 001-31540

FLEXIBLE SOLUTIONS INTERNATIONAL INC.
(Exact Name of Issuer as Specified in Its Charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

91-1922863
(I.R.S. Employer Identification No.)

615 Discovery St. Victoria, British
Columbia, Canada
(Address of Issuer's Principal Executive
Offices)

V8T 5G4
(Zip Code)

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

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One):

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Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

| Class of Stock | No. Shares Outstanding | Date |
|----------------|------------------------|----------------|
| Common | 13,169,991 | August 1, 2011 |

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

Deterioration in general or regional economic conditions;

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

Loss of customers or sales weakness;

Inability to achieve future sales levels or other operating results;

The unavailability of funds for capital expenditures; and

Operational inefficiencies in distribution or other systems.

For a detailed description of these and other factors that could cause actual results to differ materially from those expressed in any forward-looking statement, please see “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2010.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS

At June 30, 2011

(U.S. Dollars)

| | June 30, 2011 (Unaudited) | December 31, 2010 |
|--|---------------------------------|-------------------------|
| Assets | | |
| Current | | |
| Cash and cash equivalents | \$ 197,618 | \$ 2,763,420 |
| Accounts receivable | 2,950,909 | 1,198,939 |
| Inventory | 3,209,832 | 2,539,190 |
| Prepaid expenses | 195,580 | 192,269 |
| | 6,553,939 | 6,693,819 |
| Property, equipment and leaseholds | 8,507,384 | 7,867,672 |
| Patents | 225,850 | 225,180 |
| Long term deposits | 8,127 | 7,895 |
| Deferred tax asset | 199,000 | 199,000 |
| | \$ 15,494,300 | \$ 14,993,565 |
| Liabilities | | |
| Current | | |
| Accounts payable and accrued liabilities | \$ 1,034,090 | \$ 512,380 |
| Deferred revenue | 304,975 | 250,000 |
| Taxes payable | 310,000 | 620,000 |
| Short term line of credit | 500,000 | - |
| Current portion of long term debt | 336,924 | 122,726 |
| | 2,278,629 | 1,505,106 |
| Long Term | | |
| Loans | 2,001,351 | 2,206,075 |
| | \$ 4,487,340 | \$ 3,711,181 |
| 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 | | |
| 13,169,991 (2010: 13,962,567) common shares | 13,170 | 13,963 |
| Capital in excess of par value | 15,680,743 | 16,638,227 |
| Other comprehensive income | 704,877 | 554,865 |
| Deficit | (5,391,830) | (5,924,671) |
| | 11,006,960 | 11,282,384 |
| Total Stockholders' Equity | 11,006,960 | 11,282,384 |

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| | | |
|--|--------------|--------------|
| Total Liabilities and Stockholders' Equity | \$15,494,300 | \$14,993,565 |
|--|--------------|--------------|

Commitments and contingencies (Note 14 and 15)

-- See Notes to Unaudited Consolidated Financial Statements --

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months Ended June 30, 2011 and 2010
(U.S. Dollars -- Unaudited)

| | Three Months Ended June 30, | |
|--|--------------------------------|-------------|
| | 2011 | 2010 |
| Sales | \$3,930,075 | \$2,833,552 |
| Cost of sales | 2,246,652 | 1,592,647 |
| Gross profit | 1,683,423 | 1,240,905 |
| Operating expenses | | |
| Wages | 418,113 | 413,638 |
| Administrative salaries and benefits | 92,777 | 94,716 |
| Advertising and promotion | 18,865 | 23,424 |
| Investor relations and transfer agent fee | 61,842 | 25,351 |
| Office and miscellaneous | 156,990 | 94,418 |
| Insurance | 58,725 | 48,664 |
| Interest expense | 20,808 | 18,352 |
| Rent | 44,541 | 42,375 |
| Consulting | 22,703 | 23,556 |
| Professional fees | 174,368 | 50,790 |
| Travel | 39,804 | 25,434 |
| Telecommunications | 9,604 | 8,854 |
| Shipping | 8,317 | 10,490 |
| Research | 21,314 | 28,999 |
| Commissions | 30,581 | 35,071 |
| Currency exchange | 21,683 | (7,740) |
| Utilities | 12,654 | 25,023 |
| Total operating expenses | 1,213,689 | 961,414 |
| Operating income (loss) | 469,734 | 279,490 |
| Interest income | - | - |
| Income (loss) before income tax | 469,734 | 279,490 |
| Provision for income taxes | (295,000) | (413,080) |
| Net income (loss) | 174,734 | (133,590) |
| Net income (loss) per share (basic) | \$0.01 | \$(0.01) |
| Net income (loss) per share (diluted) | \$0.01 | \$(0.01) |
| Weighted average number of common shares (basic) | 13,169,991 | 13,962,567 |
| Weighted average number of common shares (diluted) | 13,294,503 | 13,962,567 |

-- See Notes to Unaudited Consolidated Financial Statements --

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Six Months Ended June 30, 2011 and 2010
(U.S. Dollars -- Unaudited)

| | Six Months Ended June 30, | |
|--|---------------------------|--------------|
| | 2011 | 2010 |
| Sales | \$8,287,542 | \$ 6,218,398 |
| Cost of sales | 4,820,600 | 3,445,179 |
| Gross profit | 3,466,942 | 2,773,219 |
| Operating expenses | | |
| Wages | 888,951 | 790,791 |
| Administrative salaries and benefits | 186,391 | 179,071 |
| Advertising and promotion | 56,475 | 52,198 |
| Investor relations and transfer agent fee | 87,666 | 48,847 |
| Office and miscellaneous | 254,325 | 194,624 |
| Insurance | 114,823 | 99,280 |
| Interest expense | 40,089 | 37,094 |
| Rent | 89,206 | 83,558 |
| Consulting | 53,394 | 56,783 |
| Professional fees | 219,299 | 92,401 |
| Travel | 72,454 | 50,937 |
| Telecommunications | 18,512 | 18,626 |
| Shipping | 16,436 | 16,358 |
| Research | 35,429 | 47,854 |
| Commissions | 97,239 | 77,455 |
| Bad debt expense (recovery) | - | 5,253 |
| Currency exchange | 34,606 | 2,544 |
| Utilities | 53,806 | 55,382 |
| | 2,319,101 | 1,909,057 |
| Income (loss) before other items and income tax | 1,147,841 | 864,162 |
| Other expenses | - | - |
| Interest income | - | -- |
| Income (loss) before income tax | 1,147,841 | 864,162 |
| Income tax (recovery) | 615,000 | 482,080 - |
| Net income (loss) | 532,841 | 382,082 |
| Net income (loss) per share (basic) | \$0.04 | \$ 0.03 |
| Net income (loss) per share (diluted) | \$0.04 | \$ 0.03 |
| Weighted average number of common shares (basic) | 13,353,904 | 13,962,567 |
| Weighted average number of common shares (diluted) | 13,412,237 | 13,962,567 |

-- See Notes to Unaudited Consolidated Financial Statements --

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30, 2011 and 2010
(U.S. Dollars -- Unaudited)

| | Six Months Ended June 30, | |
|--|---------------------------|---------------------|
| | 2011 | 2010 |
| Operating activities | | |
| Net income (loss) | \$532,841 | \$ 382,082 |
| Stock compensation expense | 71,920 | 66,621 |
| Depreciation | 163,346 | 174,558 |
| Changes in non-cash working capital items: | | |
| (Increase) Decrease in accounts receivable | (1,743,084) | (280,038) |
| (Increase) Decrease in inventory | (652,391) | (106,132) |
| (Increase) Decrease in prepaid expenses | (646) | (94,104) |
| Increase (Decrease) in accounts payable | 522,043 | (156,220) |
| Increase (Decrease) in taxes payable | (310,000) | - |
| Increase (Decrease) in deferred revenue | 54,975 | - |
| Cash provided by (used in) operating activities | (1,360,996) | (13,233) |
| Investing activities | | |
| Acquisition of property and equipment | (619,253) | (170,367) |
| Cash provided by (used in) investing activities | (619,253) | (170,367) |
| Financing activities | | |
| Short term line of credit | 500,000 | |
| Loan (repayment) | (62,466) | (25,110) |
| Purchase of common stock | (1,030,349) | - |
| Cash provided (used) by financing activities | (592,815) | (25,110) |
| Effect of exchange rate changes on cash | 7,262 | (2,789) |
| Inflow (outflow) of cash | (2,565,802) | (211,499) |
| Cash and cash equivalents, beginning | 2,763,420 | 2,138,951 |
| Cash and cash equivalents, ending | \$197,618 | \$ 1,927,452 |
| Supplemental disclosure of cash flow information: | | |
| Income taxes paid | \$925,000 | \$ 482,080 |
| Interest paid | \$40,089 | \$ 37,094 |

-- See Notes to Unaudited Consolidated Financial Statements --

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Period Ended June 30, 2011
(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, 2010 Annual Report on Form 10-K. 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 June 30, 2011, the consolidated results of operations for the three and six months ended June 30, 2011 and 2010, and the consolidated statements of cash flows for the six months ended June 30, 2011 and 2010. The results of operations for the three and six months ended June 30, 2011 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.”) and NanoChem Solutions Inc. All inter-company balances and transactions have been eliminated. The Company was incorporated May 12, 1998 in the State of Nevada and had no operations until June 30, 1998.

The Company and its subsidiaries develop, manufacture and market specialty chemicals which slow the evaporation of water. The Company’s primary product, HEAT\$AVR®, is marketed for use in swimming pools and spas where its use, by slowing the evaporation of water, allows the water to retain a higher temperature for a longer period of time and thereby reduces the energy required to maintain the desired temperature of the water in the pool. Another product, WATER\$AVR®, is marketed for water conservation in irrigation canals, aquaculture, and reservoirs where its use slows water loss due to evaporation. In addition to the water conservation products, the Company also manufactures and markets water-soluble chemicals utilizing thermal polyaspartate biopolymers (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.

2. Significant Accounting Policies.

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

(a) Cash and Cash Equivalents.

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

(b) Inventories and Cost of Sales

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

(c) Allowance for Doubtful Accounts

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

(d) Property, Equipment and Leaseholds.

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

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

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

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

(e) Impairment of Long-Lived Assets.

In accordance with FASB Codification Topic 360, "Property, Plant and Equipment (ASC 360), the Company reviews long-lived assets, including, but not limited to, property and equipment, patents and other assets, for impairment annually or whenever events or changes in circumstances indicate the carrying amounts of assets may not be recoverable. The carrying value of long-lived assets is assessed for impairment by evaluating operating performance and future undiscounted cash flows of the underlying assets. If the sum of the expected future cash flows of an asset is less than its carrying value, an impairment measurement is indicated. Impairment charges are recorded to the extent

that an asset's carrying value exceeds its fair value. Accordingly, actual results could vary significantly from such estimates. There were no impairment charges during the periods presented.

(f) Foreign Currency.

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

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

(g) 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 to the carrier has occurred, the fee is fixed or determinable, collectability 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.

(h) Stock Issued in Exchange for Services.

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

(i) Stock-based Compensation.

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

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

(j) Comprehensive Income.

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

(k) Income (loss) Per Share.

Basic earnings (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding in the period. Diluted earnings (loss) per share are calculated giving effect to the potential dilution of the exercise of options and warrants. Common equivalent shares, composed of incremental common shares issuable upon the exercise of stock options and warrants are included in diluted net income per share to the extent that these shares are dilutive. Common equivalent shares that have an anti-dilutive effect on net income per share have been excluded from the calculation of diluted weighted average shares outstanding for the three and six months ended June 30, 2011 and 2010.

(l) Use of Estimates.

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

(m) Financial Instruments.

The fair market value of the Company's financial instruments comprising cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities 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.

(n) Fair Value of Financial Instruments

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

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

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

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

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

The fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities for all periods presented approximate their respective carrying amounts due to the short term nature of these financial instruments. Long term debt relates to borrowings from governmental entities and as such no interest has been imputed on the non-interest bearing loan.

(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 potential material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

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

(p) Income Taxes

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

Per FASB ASC 740 "Income taxes" under the liability method, it is the Company's policy to provide for uncertain tax positions and the related interest and penalties based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. At June 30, 2011, the Company believes it has appropriately accounted for any unrecognized tax benefits. To the extent the Company prevails in matters for which a liability for an unrecognized benefit is established or is required to pay amounts in excess of the liability, the Company's effective tax rate in a given financial statement period may be affected. Interest and penalties associated with the Company's tax positions are recorded as Interest Expense.

(q) Risk Management

The Company's credit risk is primarily attributable to its account receivables. The amounts presented in the accompanying consolidated balance sheets are net of allowances for doubtful accounts, estimated by the Company's management based on prior experience and the current economic environment. The Company is exposed to credit-related losses in the event of non-performance by counterparties to the financial instruments. Credit exposure is minimized by dealing with only credit worthy counterparties. Accounts receivable for the three primary customers totals \$1,683,464 (57%) as at June 30, 2011 (2010 - \$1,010,027 or 56%).

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

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

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

(r) Recently Adopted Accounting Pronouncements

In December 2010, the FASB issued ASU No. 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations (ASU 2010-29). The amendments in this ASU specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplementary pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The adoption of ASU 2010-29 on January 1, 2011 did not have a material impact on the Company's Consolidated Financial Statements.

In December 2010, the FASB issued ASU No. 2010-28, Intangibles – Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (ASU 2010-28). For reporting units with zero or negative carrying amounts, this ASU requires that an entity perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples, which require that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The adoption of ASU 2010-28 on January 1, 2011 did not have an impact on the Company's Consolidated Financial Statements.

(s) Recent Accounting Pronouncements

In May 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and the International Financial Reporting Standards (IFRS). The amendments in this Update are intended to result in convergence between U.S.

GAAP and IFRS requirements for measurement of, and disclosures about, fair value. ASU 2011-04 clarifies or changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. The amendments in this update are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. The Company is evaluating the impact this standard may have on its consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. This guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. The guidance allows two presentation alternatives: (1) present items of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income; or (2) in two separate, but consecutive, statements of net income and other comprehensive income. This standard is effective during interim and annual periods beginning after December 15, 2011. Early adoption is permitted, but full retrospective application is required under both sets of accounting standards. The Company is evaluating the impact this standard may have on its consolidated financial statements.

3. Accounts Receivable

| | June 30, 2011 | December 31, 2010 |
|----------------------------------|------------------|----------------------|
| Accounts receivable | \$ 2,964,819 | \$ 1,212,428 |
| Allowances for doubtful accounts | (13,910) | (13,489) |
| | \$ 2,950,909 | \$ 1,198,939 |

The Company has pledged \$381,129 (2010 - \$190,889) of the above listed accounts receivable as collateral for the Flexible Solutions Ltd. loan from AFSC (see Note 9b).

4. Inventories

| | June 30, 2011 | December 31, 2010 |
|-------------------|------------------|----------------------|
| Completed goods | \$ 2,295,989 | \$ 1,354,578 |
| Works in progress | 179,743 | 142,824 |
| Raw materials | 734,100 | 1,041,788 |
| | \$ 3,209,832 | \$ 2,539,190 |

5. Property, Plant & equipment

| | 2011 Cost | Accumulated Depreciation | 2011 Net |
|--|---------------|-----------------------------|--------------|
| Buildings | \$ 3,216,859 | \$ 1,649,274 | \$ 1,567,585 |
| Plant under construction and equipment | 5,818,794 | — | 5,818,794 |
| Computer hardware | 102,735 | 78,385 | 24,350 |
| Furniture and fixtures | 29,014 | 20,084 | 8,930 |
| Office equipment | 24,702 | 20,130 | 4,572 |
| Manufacturing equipment | 2,430,178 | 1,848,721 | 581,457 |
| Trailer | 28,941 | 19,739 | 9,202 |
| Trade show booth | 9,009 | 8,244 | 765 |
| Truck | 12,327 | 7,963 | 4,364 |
| Land | 487,365 | — | 487,365 |
| | \$ 12,159,924 | \$ 3,652,540 | \$ 8,507,384 |

| | 2010 Cost | Accumulated Depreciation | 2010 Net |
|--|---------------|-----------------------------|--------------|
| Buildings | \$ 3,216,859 | \$ 1,566,462 | \$ 1,650,397 |
| Plant under construction and equipment | 5,059,497 | — | 5,059,497 |
| Computer hardware | 100,733 | 72,557 | 28,176 |
| Furniture and fixtures | 28,391 | 18,654 | 9,737 |
| Office equipment | 23,954 | 19,028 | 4,926 |
| Manufacturing equipment | 2,392,162 | 1,772,207 | 619,955 |
| Trailer | 28,065 | 17,566 | 10,498 |
| Trade show booth | 8,736 | 7,863 | 873 |
| Truck | 11,954 | 6,976 | 4,979 |
| Land | 478,634 | — | 478,634 |
| | \$ 11,348,985 | \$ 3,481,313 | \$ 7,867,672 |

Amount of depreciation expense for 2011: \$163,345 (2010: \$174,558)

As of June 30, 2011, the following capitalized costs pertaining to the Company's new plant in Taber, Alberta are classified as Plant Under Construction and Equipment and include contracted costs and supplies. Interest costs are expensed as incurred. The Company will not begin depreciating the Plant and Equipment until it becomes operational.

| | June 30, 2011 | December 31, 2010 |
|-------------------------|------------------|----------------------|
| Building | 1,096,684 | 1,063,471 |
| Building improvements | 1,122,338 | 1,085,613 |
| Manufacturing equipment | 3,458,134 | 2,773,064 |
| Technology | 141,638 | 137,349 |
| | 5,818,794 | 5,059,497 |

The following carrying amount of capital assets held by Flexible Solutions Ltd. serves as collateral for the AFSC loan. (See Note 9b):

| | |
|-------------------------|-----------|
| Land | \$288,272 |
| Building | 1,092,980 |
| Building improvements | 1,122,338 |
| Manufacturing equipment | 3,522,096 |
| Trailer | 9,202 |
| Truck | 4,364 |
| Trade show booth | 765 |
| Technology | 141,638 |

6. 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.

Of the patents costs listed below, \$81,466(2010 - \$79,582) are not subject to amortization as of June 30, 2011, as the patents are still in the process of being approved.

| | 2011 Cost | Accumulated Amortization | 2011 Net |
|---------|--------------|-----------------------------|-------------|
| Patents | \$ 274,836 | \$ 48,986 | \$ 225,850 |

| | 2010 Cost | Accumulated Amortization | 2010 Net |
|---------|--------------|-----------------------------|-------------|
| Patents | \$ 266,530 | \$ 41,350 | \$ 225,180 |

Increase in 2011 cost was due to currency conversion. 2011 cost in Canadian dollars - \$265,102 (2010 - \$265,102 in Canadian dollars).

Amount of depreciation for 2011 - \$6,264 (2010 - \$5,069)

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

| | |
|------|----------|
| 2011 | \$12,688 |
| 2012 | 12,688 |
| 2013 | 12,688 |
| 2014 | 12,688 |
| 2015 | 12,688 |

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.

| | | |
|--------------------|----------|----------|
| | 2011 | 2010 |
| Long term deposits | \$ 8,127 | \$ 7,895 |

8. Short-Term Line of Credit

On February 28, 2011, the Company entered into a Business Loan Agreement (the Revolving Line of Credit Agreement) with Harris Bank (the Bank). The Revolving Line of Credit Agreement provides for a secured working capital-based revolving line of credit (the Revolving Line) in an aggregate amount of up to the lesser of (i) \$1,500,000, or (ii) 75% of eligible domestic accounts receivable and certain foreign accounts receivable plus 40% of inventory. Amounts advanced under the Revolving Line bear interest at an annual rate equal to the lender's prime rate plus 0.75%. Interest on the Revolving Line is due monthly, with the balance due on February 28, 2012, which is the scheduled maturity date for the Revolving Line.

The Revolving Line of Credit contains customary affirmative and negative covenants, including the following: compliance with laws, provision of financial statements and periodic reports, payment of taxes, maintenance of inventory and insurance, maintenance of operating accounts at the Bank, the Bank's access to collateral, formation or acquisition of subsidiaries, incurrence of indebtedness, dispositions of assets, granting liens, changes in business, ownership or business locations, engaging in mergers and acquisitions, making investments or distributions and affiliate transactions. The covenants also require that the Company maintain a minimum ratio of qualifying financial assets to the sum of qualifying financial obligations.

To secure the repayment of any amounts borrowed under the Revolving Line of Credit, the Company granted to the Bank a security interest in substantially all of its assets of NanoChem Solutions Inc., which assets do not include its intellectual property assets.

Short-term borrowings outstanding under the Revolving Line as of June 30, 2011 were \$500,000. The weighted-average interest rate on short-term borrowings outstanding as of June 30, 2011 was 4.0%.

9. Long Term Debt

(a) The Company has received a non-interest bearing loan from the Department of Agriculture and Agri-Food Canada ("AAFC"). Eligible for up to \$1,000,000 Canadian funds, the Company had an outstanding balance of \$910,801 in Canadian funds (\$944,319 US) as of June 30, 2011, on an unsecured basis. If the full amount is borrowed, the repayment schedule is as follows:

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

(b) The Company has also received a 5% simple interest loan from Agriculture Financial Services Corp. ("AFSC"). Eligible for up to \$2,000,000 Canadian funds, the Company had an outstanding balance of \$1,344,479 in Canadian funds (\$1,393,956 US) as of June 30, 2011. The Company was required to make interest payments until May 1, 2010 and then effective May 1, 2010 equal monthly payments of principal and interest of \$15,829 in Canadian funds (\$16,412 US) until May 1, 2014. The Company has pledged its building in Taber, Alberta, as well as equipment, inventory and accounts receivable (see Notes 3 and 5) as collateral, as well as signed a promissory note guaranteeing the amount of the loan.

Continuity:

| | | |
|------------------------------|----|-----------|
| Balance at December 31, 2009 | \$ | 2,285,314 |
| Less: loan repayment | | (75,642) |
| Effect of exchange rate | | 119,129 |
| Balance at December 31, 2010 | \$ | 2,328,801 |
| Less: loan repayment | | (62,465) |
| Effect of exchange rate | | 71,939 |
| Balance at June 30, 2011 | \$ | 2,338,275 |

| Outstanding balance at: | 2011 | 2010 |
|--------------------------|--------------|--------------|
| a) Long term debt – AAFC | \$ 944,319 | \$ 915,719 |
| b) Long term debt – AFSC | 1,393,956 | 1,413,082 |
| Long term debt | \$ 2,338,275 | \$ 2,328,801 |
| Less current portion | (336,924) | (122,726) |
| | \$ 2,001,351 | \$ 2,206,075 |

10. Stock Options

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

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 options is 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, 2009, 2010 and the period ended June 30, 2011:

| | Number of shares | Exercise price per share | Weighted average exercise price |
|----------------------------|---------------------|-----------------------------|---------------------------------------|
| Balance, December 31, 2008 | 1,910,700 | \$ 3.00 - \$ 4.55 | \$ 3.38 |
| Granted | 122,000 | \$ 2.25 | \$ 2.25 |
| Cancelled or expired | (204,740) | \$ 3.00 - \$ 4.60 | \$ 3.74 |
| Balance, December 31, 2009 | 1,546,700 | \$ 2.25 - \$ 3.85 | \$ 3.25 |
| Granted | 315,000 | \$ 1.50 - \$ 2.25 | \$ 1.87 |
| Cancelled or expired | (25,000) | \$ 1.50 - \$ 3.85 | \$ 1.97 |
| Balance, December 31, 2010 | 1,836,700 | \$ 1.50 - \$ 3.60 | \$ 3.03 |
| Granted | 358,000 | \$ 1.50 - \$ 2.00 | \$ 1.61 |
| Cancelled or expired | 1,177,000 | \$ 1.90 - \$ 3.60 | \$ 3.20 |
| Balance, June 30, 2011 | 1,017,700 | \$ 1.50 - \$ 3.60 | \$ 2.34 |
| Exercisable, June 30, 2011 | 568,700 | \$ 1.50 - \$ 3.60 | \$ 2.10 |

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

| | 2011 | 2010 |
|--|-------------------|--------------|
| Expected life – years | 5.0 | 5.0 |
| Interest rate | 1.8 % | 1.4 – 2.49% |
| Volatility | 62 % | 60 % |
| Dividend yield | — % | — % |
| Weighted average fair value of options granted | \$ 0.39 - \$ 0.50 | \$ 0.29-0.70 |

During the six months ended June 30, 2011 the Company granted 196,000 options to consultants that resulted in \$25,495 in expenses this period. During the same period, 162,000 options were granted to employees, resulting in \$34,635 in expenses this period. Options granted in previous quarters resulted in additional expenses in the amount of \$11,942 for employees during the six months ended June 30, 2011. No stock options were exercised during the period.

During the six months ended June 30, 2010 the Company granted 61,000 options to consultants that resulted in \$10,016 in expenses this period. During the same period, 254,000 options were granted to employees, resulting in \$24,291 in expenses this period. Options granted in previous quarters resulted in additional expenses in the amount of \$10,570 for consultants and \$21,742 for employees during the six months ended June 30, 2010. No stock options were exercised during the period.

11. Warrants

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

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

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

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

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

The following table summarizes the Company's warrant activity for the three years ended December 30, 2010 (no subsequent activity):

| | Number of Shares | Exercise price per share | Weighted average exercise price |
|---|---------------------|--------------------------------|---------------------------------------|
| Balance December 31, 2007 and 2008 | 1,477,440 | \$ 4.50 | \$ 4.50 |
| Granted | - | - | - |
| Exercised | - | - | - |
| Cancelled/Expired | 987,400 | \$ 4.50 | \$ 4.50 |
| Balance December 31, 2009 | 490,040 | \$ 3.00 | \$ 3.00 |
| Granted | - | - | - |
| Exercised | - | - | - |
| Cancelled/Expired | 490,040 | \$ 3.00 | \$ 3.00 |
| Balance December 31, 2010 and June 30, 2011 | - | - | - |

12. Capital Stock.

On February 16, 2011 the Company repurchased and cancelled 792,576 shares of common stock for \$1.30 per share, for a total of \$1,030,349.

13. Segmented, Significant Customer Information and Economic Dependency.

The Company operates in two segments:

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

(b) Manufacture of biodegradable polymers ("BCPA's") used by the petroleum, chemical, utility and mining industries to prevent corrosion and scaling in water piping. This product can also be used in detergents to increase

biodegradability and in agriculture to increase crop yields by enhancing fertilizer uptake.

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

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

Six months ended June 30, 2011:

| | EWCP | BPCA | Total |
|---------------------------------|------------|--------------|--------------|
| Revenue | \$ 686,567 | \$ 7,600,975 | \$ 8,287,542 |
| Interest revenue | - | - | - |
| Interest expense | 36,500 | 3,589 | 40,089 |
| Depreciation and amortization | 21,812 | 141,533 | 163,345 |
| Segment profit (loss) | (868,823) | 1,401,664 | 532,841 |
| Segment assets | 6,204,106 | 2,303,278 | 8,507,384 |
| Expenditures for segment assets | 592,229 | 27,024 | 619,253 |

Six months ended June 30, 2010:

| | EWCP | BPCA | Total |
|---------------------------------|------------|--------------|--------------|
| Revenue | \$ 652,467 | \$ 5,565,931 | \$ 6,218,398 |
| Interest revenue | - | - | - |
| Interest expense | 35,829 | 1,265 | 37,094 |
| Depreciation and amortization | 22,686 | 151,872 | 174,558 |
| Segment profit (loss) | (776,937) | 1,159,019 | 382,082 |
| Segment assets | 5,005,246 | 2,462,930 | 7,468,176 |
| Expenditures for segment assets | 151,315 | 19,053 | 170,368 |

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

| | 2011 | 2010 |
|--------------------------|--------------|--------------|
| Canada | \$ 388,500 | \$ 271,961 |
| United States and abroad | 7,899,042 | 5,946,437 |
| Total | \$ 8,287,542 | \$ 6,218,398 |

The Company's property, equipment, leasehold and patents are located in Canada and the United States as follows:

| | 2011 | 2010 |
|---------------|--------------|--------------|
| Canada | \$ 6,430,809 | \$ 5,675,065 |
| United States | 2,302,425 | 2,417,787 |
| Total | \$ 8,733,234 | \$ 8,092,852 |

Three customers accounted for \$4,583,941 (55%) of sales made in the period (2010 - \$3,472,850 or 56%).

14. Commitments.

The Company is committed to minimum rental payments for property and premises aggregating approximately \$291,101 over the term of three leases, the last expiring on July 31, 2014.

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

| | |
|------|--------|
| 2011 | 80,472 |
| 2012 | 78,974 |
| 2013 | 82,178 |
| 2014 | 49,477 |

15. Contingencies

On June 29, 2011, WaterSavr Singapore Pte. Ltd., a former distributor of the Company's WATERSAVR product, filed a dispute with the American Arbitration Association of New York, NY, USA for multiple claims. The Company denied the allegations and intends to defend itself vigorously. At this time the amount and outcome of the claim is indeterminable.

16. Comparative Figures.

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

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATION AND FINANCIAL CONDITION.

Overview

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

Results of Operations

The Company has two product lines:

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

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

Material changes in the Company's Statement of Operations for the three and six months ended June 30, 2011 are discussed below:

Six Months ended June 30, 2011

| Item | Increase (I) or Decrease (D) | Reason |
|--------------------------|------------------------------------|--|
| Sales | | |
| EWCP products | I | Increase in customers' inventory to more normal level has resulted in greater sales. |
| BPCA products | I | Increased sales across all markets due to increased success in marketing. |
| Gross Profit | I | Increased sales. |
| Wages | I | Increased sales. |
| Office and miscellaneous | I | Various administrative costs associated with the start up of the new facility have been allocated to this account. Once the facility is operational, these costs will be allocated to overhead |
| Professional fees | I | Legal costs to protect the Company's intellectual property have increased due to new patent filings and some litigation costs. |

| | | |
|-------------|---|------------------|
| Commissions | I | Increased sales. |
|-------------|---|------------------|

22

Three months ended June 30, 2011

| Item | Increase (I) or Decrease (D) | Reason |
|--|---------------------------------------|---|
| Sales | | |
| EWCP products | I | Increase in customers' inventory to more normal level has resulted in greater sales. |
| BPCA products | I | Increased sales across all markets due to increased success in marketing. |
| Gross Profit | I | Increased sales. |
| Investor relations and transfer agent fees | I | Additional costs have been contracted to increase investor awareness of the Company |
| Office and Miscellaneous | I | Various administrative costs associated with the start up of the new facility have been allocated to this account. Once the facility is operational, these costs will be allocated to overhead. |
| Professional fees | I | Legal costs to protect the Company's intellectual property have increased due to new patent filings and some litigation costs. |
| Commission | D | Uncommissionable sales increased against commissionable sales. |

Capital Resources and Liquidity

The Company's sources and (uses) of cash for the six months ended June 30, 2011 and 2010 are shown below:

| | 2011 | 2010 |
|------------------------------------|-------------|------------|
| Cash used by operations | (1,360,996) | (13,233) |
| Construction of plant in Taber, AB | (593,082) | (151,315) |
| Purchases of equipment | (26,171) | (19,053) |
| Short term line of credit | 500,000 | - |
| Repayment of loans | (62,466) | (25,110) |
| Purchase of common stock | (1,030,349) | - |
| Changes in exchange rates | 7,272 | (2,789) |

In February 2011 the Company purchased 792,576 shares of its common stock from unrelated third parties. The shares were acquired in privately negotiated transactions for a total purchase price of \$1,030,349. None of the share were acquired in open market transactions.

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

The Company expects that the Taber plant will begin commercial production in 2011 and expects to spend approximately another \$50,000 before commercial production begins.

The Company has sufficient cash resources to meets its future commitments and cash flow requirements for the coming year. As of June 30, 2011 working capital was \$4,067,950 (2010 - \$5,118,713) and the Company has no substantial commitments that require significant outlays of cash over the coming fiscal year other than repayment of the long-term loans.

The Company is committed to minimum rental payments for property and premises aggregating approximately \$291,101 over the term of three leases, the last expiring on July 31, 2014.

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

| | |
|------|--------|
| 2011 | 80,472 |
| 2012 | 78,974 |
| 2013 | 82,178 |
| 2014 | 49,477 |

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

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

See Note 8 to the financial statements included as part of this report for a description of the Company's revolving line of credit.

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the direction and with the participation of our management, including our Principal Executive and Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2011. We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports with the Securities and Exchange Commission is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations, and that such information is accumulated and communicated to our management, including our principal executive and financial officer, as appropriate, to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide a reasonable level of assurance of reaching desired disclosure control objectives. Based on the evaluation, our Principal Executive and Financial Officer concluded that these disclosure controls and procedures are effective as of June 30, 2011.

Changes in Internal Control over Financial Reporting

Our management, with the participation of our Principal Executive and Financial Officer, evaluated whether any change in our internal control over financial reporting occurred during the three months ended June 30, 2011. Based on that evaluation, it was concluded that there has been no change in our internal control over financial reporting during the three months ended June 30, 2011 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

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 and Financial Officer Pursuant to 18 U.S.C. §1350 and §906 of the Sarbanes-Oxley Act of 2002.* |

* Filed with this report.

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

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.

August 15, 2011

By: /s/ Daniel B. O'Brien
Name Daniel B. O'Brien
Title President and Principal Executive Officer

By: /s/ Daniel B. O'Brien
Name: Daniel B. O'Brien
Title: Principal Financial and Accounting Officer

