

FLEXIBLE SOLUTIONS INTERNATIONAL INC
Form 10-Q
August 14, 2014

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, 2014

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.)

#206 – 920 Hillside Ave.
Victoria, British Columbia,
Canada
(Address of Issuer's Principal
Executive Offices)

V8T 1Z8
(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 ☐

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

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☒

(Do not check if a smaller reporting company)

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

	Yes ☐	No ☒
Class of Stock	No. Shares Outstanding	Date
Common	13,169,991	August 1, 2014

FORM 10-Q

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

Forward-looking statements may include the words “may,” “could,” “will,” “estimate,” “intend,” “continue,” “believe,” “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, 2013.

PART I FINANCIAL INFORMATION
Item 1. Financial Statements.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(U.S. Dollars)

	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Current		
Cash and cash equivalents	\$495,931	\$568,087
Accounts receivable (Note 3)	2,242,784	2,012,115
Inventory (Note 4)	3,017,735	3,061,536
Prepaid expenses	103,039	126,952
	5,859,489	5,768,690
Property, equipment and leaseholds (Note 5)	5,511,091	5,831,123
Patents (Note 6)	158,836	168,868
Long term deposits (Note 7)	4,768	4,781
Deferred tax asset	2,563,421	2,700,506
	\$14,097,605	\$14,473,968
Liabilities		
Current		
Accounts payable and accrued liabilities	\$457,339	\$570,476
Deferred revenue	6,467	13,550
Taxes payable	(281,202)	(281,202)
Short term line of credit (Note 8)	1,000,000	1,400,000
Current portion of long term debt (Note 9)	1,068,506	304,556
	2,251,110	2,007,380
Long Term		
Loans (Note 9)	158,988	993,274
	\$2,410,098	\$3,000,654
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 common shares at June 30, 2014 and December 31, 2013	13,170	13,170
Capital in excess of par value	16,177,339	16,135,953
Other comprehensive income	257,318	328,686
Deficit	(4,760,320)	(5,004,495)
Total Stockholders' Equity	11,687,507	11,473,314
Total Liabilities and Stockholders' Equity	\$14,097,605	\$14,473,968

Commitments and contingencies (Note 13)

-- See Notes to Unaudited Consolidated Financial Statements --

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE
INCOME (LOSS)

For the Three Months Ended June 30, 2014 and 2013
(U.S. Dollars -- Unaudited)

	Three Months Ended June 30,	
	2014	2013
Sales	\$4,286,731	\$4,884,629
Cost of sales	2,732,022	3,311,257
Gross profit	1,554,709	1,573,372
Operating expenses		
Wages	381,913	468,524
Administrative salaries and benefits	199,659	203,466
Advertising and promotion	5,476	10,941
Investor relations and transfer agent fee	54,494	58,768
Office and miscellaneous	62,586	214,942
Insurance	71,874	49,834
Interest expense	25,940	46,484
Rent	50,562	45,711
Consulting	58,357	83,361
Professional fees	53,557	81,948
Travel	24,763	26,833
Telecommunications	8,158	8,913
Shipping	6,459	6,999
Research	32,020	66,943
Commissions	6,843	46,871
Bad debt expense	-	27,225
Currency exchange	1,263	4,483
Utilities	12,323	38,957
Total operating expenses	1,056,247	1,491,203
Income (loss) before other items and income tax	498,462	82,169
Income (loss) before income tax	498,462	82,169
Provision for income taxes	98,709	12,000
Net income (loss)	399,753	70,169
Other comprehensive income (loss)	190,976	(129,507)
Comprehensive income (loss)	590,729	(59,338)
Net income (loss) per share (basic and diluted)	\$0.03	\$0.00
Weighted average number of common shares (basic and diluted)	13,169,991	13,169,991

-- See Notes to Unaudited Consolidated Financial Statements --

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE
INCOME (LOSS)

For the Six Months Ended June 30, 2014 and 2013
(U.S. Dollars -- Unaudited)

	Six Months Ended June 30,	
	2014	2013
Sales	\$8,099,712	\$9,389,164
Cost of sales	5,390,848	6,469,640
Gross profit	2,708,864	2,919,524
Operating expenses		
Wages	802,116	921,390
Administrative salaries and benefits	398,609	414,014
Advertising and promotion	27,950	17,663
Investor relations and transfer agent fee	103,197	115,516
Office and miscellaneous	172,294	333,230
Insurance	146,917	121,292
Interest expense	52,772	55,880
Rent	100,525	91,710
Consulting	138,903	161,616
Professional fees	148,655	125,173
Travel	54,662	61,784
Telecommunications	15,185	15,736
Shipping	17,867	14,213
Research	76,542	80,155
Commissions	70,678	86,340
Bad debt expense (recovery)	-	27,225
Currency exchange	(4,149)	5,030
Utilities	43,257	68,285
	2,365,980	2,716,252
Income (loss) before other items and income tax	342,884	203,272
Gain on sale of equipment	-	2,057
Income (loss) before income tax	342,884	205,329
Provision for income taxes	98,709	70,000
Net income (loss)	244,175	135,329
Other comprehensive income (loss)	(71,368)	(206,564)
Comprehensive income (loss)	\$172,807	\$(71,235)
Net income (loss) per share (basic and diluted)	\$0.01	\$(0.01)
Weighted average number of common shares (basic and diluted)	13,169,991	13,169,991

-- See Notes to Unaudited Consolidated Financial Statements --

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30, 2014 and 2013
(U.S. Dollars -- Unaudited)

	Six Months Ended June 30,	
	2014	2013
Operating activities		
Net income (loss)	\$244,175	\$135,329
Stock compensation expense	41,385	59,500
Depreciation	325,886	656,486
Changes in non-cash working capital items:		
(Increase) Decrease in accounts receivable	(251,758)	(548,219)
(Increase) Decrease in inventory	39,413	236,544
(Increase) Decrease in prepaid expenses	22,561	(106,564)
(Increase) Decrease in deferred tax assets	98,709	-
Increase (Decrease) in accounts payable	(101,586)	(141,512)
Increase (Decrease) in taxes payable	-	(120,000)
Increase (Decrease) in deferred revenue	(6,848)	(54,975)
Cash provided by (used in) operating activities	411,937	116,589
Investing activities		
Acquisition of property and equipment	(16,190)	(55,487)
Cash provided by (used in) investing activities	(16,190)	(55,487)
Financing activities		
Short term line of credit (repayment)	(400,000)	195,000
Repayments of loans	(64,393)	(84,488)
Cash provided (used) by financing activities	(464,393)	110,512
Effect of exchange rate changes on cash	(3,510)	(21,118)
Inflow (outflow) of cash	(72,156)	150,496
Cash and cash equivalents, beginning	568,087	381,867
Cash and cash equivalents, ending	\$495,931	\$512,363
Supplemental disclosure of cash flow information:		
Income taxes paid	\$-	\$190,000
Interest paid	\$55,103	\$77,349

-- See Notes to Unaudited Consolidated Financial Statements --

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the Period Ended June 30, 2014
(U.S. Dollars)

1. Basis of Presentation.

These condensed consolidated interim financial statements include the accounts of Flexible Solutions International, Inc. (the “Company”, “we”, or “our”), and its wholly-owned subsidiaries Flexible Fermentation Ltd. (“Flexible Ltd.”) NanoChem Solutions Inc. (“NanoChem”), Flexible Solutions Ltd., Flexible Biomass LP, and FS Biomass 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. One of the Company’s products, HEATSAVR®, 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, WATERSAVR®, 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.

These unaudited condensed consolidated interim financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States for interim financial statements. 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, 2013 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, 2014, the consolidated results of operations for the three and six months ended June 30, 2014 and 2013, and the consolidated statements of cash flows for the six months ended June 30, 2014 and 2013. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the entire fiscal year.

2. Significant Accounting Policies.

These condensed consolidated interim 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
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

Property and equipment are written down to net realizable value when management determines there has been a change in circumstances which indicates its carrying amount may not be recoverable. No write-downs have been necessary to date.

(e) Impairment of Long-Lived Assets.

In accordance with 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 three 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 the Statement of Comprehensive Income.

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

(g) Revenue Recognition.

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

Deferred revenues consist of products sold to distributors with payment terms greater than the Company's customary business terms due to lack of credit history or operating in a new market in which the Company has no prior experience. The Company defers the recognition of revenue until the criteria for revenue recognition have been met, and payments become due or cash is received from these distributors.

(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. Shares are issued from treasury upon exercise of stock options.

(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, 2014 and 2013.

(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.

Estimates and underlying assumptions are reviewed at each period end. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Significant areas requiring the use of management estimates include assumptions and estimates relating to the asset impairment analysis, share-based payments and warrants, valuation allowances for deferred income tax assets, determination of useful lives of property, plant and equipment, and the valuation of inventory.

(m) Financial Instruments.

The fair market value of the Company's financial instruments, comprising cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, short term line of credit, and loan, 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, accrued liabilities and short term line of credit for all periods presented approximate their respective carrying amounts due to the short term nature of these financial instruments. No interest has been imputed on the non-interest bearing loan from Agriculture and Agri-Food Canada. (see Note 9).

(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 carry-forwards. 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, 2014, 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 Company's three primary customers totaled \$1,648,558 (74%) at June 30, 2014 (December 31, 2013 - \$1,473,682 or 73%).

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, and accounts payable.

(r) Recently Adopted Accounting Pronouncements

In January 2013, the FASB issued ASU 2013-01, Balance Sheet (Topic 210) - Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. This amendment requires companies to disclose information about financial instruments that have been offset and related arrangements to enable users of the company's financial statements to understand the effect of those arrangements on the company's financial position. Companies will be required to provide both net (offset amounts) and gross information in the notes to the financial statements for relevant assets and liabilities that are offset. The guidance is effective for the Company's interim and annual periods beginning after January 1, 2013. Adoption of this amendment had no impact on the on the Company's balance sheet or results of operations.

3. Accounts Receivable

	June 30, 2014	December 31, 2013
Accounts receivable	\$2,287,490	\$2,056,964
Allowances for doubtful accounts	(44,706)	(44,849)
	\$2,242,784	\$2,012,115

The Company has pledged \$148,902 of the above listed accounts receivable as collateral for the Flexible Solutions Ltd. loan from AFSC (see Note 9b).

4. Inventory

	June 30, 2014	December 31, 2013
Completed goods	\$1,615,637	\$1,527,563
Works in progress	101,809	34,702
Raw materials	1,300,289	1,499,271
	\$3,017,735	\$3,061,536

5. Property, Plant & equipment

	June 30, 2014 Cost	Accumulated Depreciation	June 30, 2014 Net
Buildings	\$5,226,713	\$ 2,558,355	\$2,668,358
Computer hardware	102,029	91,879	10,150
Furniture and fixtures	27,039	22,738	4,301
Office equipment	22,329	20,213	2,116
Manufacturing equipment	6,017,791	3,717,212	2,300,579
Trailer	16,181	14,282	1,899
Technology	128,032	64,016	64,016
Land	459,672	—	459,672
	\$11,999,786	\$ 6,488,695	\$5,511,091

	December 31, 2013 Cost	Accumulated Depreciation	December 31, 2013 Net
Buildings	\$ 5,233,147	\$ 2,419,217	\$ 2,813,930
Computer hardware	102,225	90,265	11,960
Furniture and fixtures	27,098	22,310	4,788
Office equipment	22,400	20,042	2,358
Manufacturing equipment	6,014,006	3,555,731	2,458,275
Trailer	16,233	13,992	2,241
Technology	128,442	51,377	77,065
Land	460,506	-	460,506
	\$ 12,004,057	\$ 6,172,934	\$ 5,831,123

Amount of depreciation expense for 2014: \$316,649 (2013: \$646,523)

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

Land	\$260,579
Building	739,134
Building improvements	783,753
Manufacturing equipment	1,994,882
Trailer	1,899
Technology	64,016

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.

	June 30, 2014 Cost	Accumulated Amortization	June 30, 2014 Net
Patents	\$248,490	\$ 89,654	\$158,836

	December 31, 2013 Cost	Accumulated Amortization	December 31, 2013 Net
Patents	\$249,284	\$ 80,416	\$168,868

Decrease in 2014 cost was due to currency conversion. 2014 cost in Canadian dollars - \$265,102 (2013 - \$265,102 in Canadian dollars).

Amount of depreciation for 2014 - \$9,237 (2013 - \$9,963)

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

2014	\$18,990
2015	18,990
2016	18,990
2017	18,990
2018	18,990

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.

	June 30, 2014	December 31, 2013
Long term deposits	\$4,768	\$4,781

8. Short-Term Line of Credit

In March 2012, the Company signed a new agreement with Harris Bank to replace the expiring credit line. The revolving line of credit was increased to an aggregate amount of up to the lesser of (i) \$5,000,000, or (ii) 75% of eligible domestic accounts receivable and certain foreign accounts receivable plus 40% of inventory. The Company can borrow an additional \$1,400,000 using other assets as collateral. The loan has an annual interest rate of 3.75%.

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. As of June 30, 2014, Company was in compliance with all loan covenants.

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 the assets of NanoChem Solutions Inc., exclusive of intellectual property assets.

Short-term borrowings outstanding under the Revolving Line as of June 30, 2014 were \$1,000,000 (December 31, 2013 - \$1,400,000) and there were no amounts outstanding on the secured loan.

9. Long Term Debt

(a) Flexible Solutions Ltd. has received a non-interest bearing, unsecured loan from the Department of Agriculture and Agri-Food Canada ("AAFC"). Eligible for up to \$1,000,000 in Canadian funds, the Company had borrowed \$910,801 in Canadian funds (US\$853,603) as of June 30, 2014 on an unsecured basis (December 31, 2013 - CDN\$910,801; US\$856,335). The balance owing at June 30, 2014 was \$364,320 in Canadian funds (US\$341,441); (December 31, 2013 - \$364,320CDN; US\$342,534). The repayment schedule is as follows:

Amount Due (in CDN funds)	Payment Due Date
\$182,160	December 31, 2014
\$182,160	December 31, 2015

(b) Flexible Solutions Ltd. has also received a 5% simple interest loan from Agriculture Financial Services Corp. ("AFSC"). Eligible for up to \$2,000,000 in Canadian funds, the Company had originally borrowed \$1,491,000 in Canadian funds. The Company was required to make interest payments until May 1, 2010 and then started to pay down the principal in equal payments until April 1, 2015. The borrowing balance at June 30, 2014 was \$945,426 in Canadian funds (US\$886,053). The borrowing balance at December 31, 2013 was \$1,016,056 in Canadian funds (US\$955,296). The Company has pledged the assets of the Taber, AB building, including 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.

The Company has committed to the following repayments:

2014	\$89,007
2015	\$870,362

As of June 30, 2014, the Company was in compliance with all loan covenants.

	June 30, 2014	December 31, 2013
Continuity		
Balance, beginning of period	\$1,297,830	\$1,726,050
Less: Payments on loan	32,592	307,833
Effect of exchange rate	(37,744)	(120,387)
Balance, end of period	\$1,227,494	\$1,297,830

Outstanding balance at:

a) Long term debt – AAFC	\$ 341,441	\$ 342,534
b) Long term debt – AFSC	886,053	955,296
Long term debt	\$ 1,227,494	\$ 1,297,830
Less: current portion	(1,068,506)	(304,556)
Balance	\$ 158,988	\$ 993,274

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 year ended December 31, 2013 and the six month period ended June 30, 2014:

	Number of shares	Exercise price per share	Weighted average exercise price
Balance, December 31, 2012	999,000	\$ 1.50 – 2.45	\$ 1.96
Granted	233,000	\$ 1.21 – 1.50	\$ 1.27
Cancelled or expired	(68,000)	\$ 3.60	\$ 3.60
Balance, December 31, 2013	1,164,000	\$ 1.21 – 2.45	\$ 1.73
Granted	212,000	\$ 1.00	\$ 1.00
Cancelled or expired	(113,000)	\$ 2.25	\$ 2.25
Balance, June 30, 2014	1,263,000	\$ 1.21 – 2.45	\$ 1.56
Exercisable, June 30, 2014	921,000	\$ 1.21 – 2.45	\$ 1.69

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

	2014		2013
Expected life – years	5.0		5.0
Interest rate	0.78	%	0.36 – 0.63
Volatility	58	%	51 – 63
Dividend yield	—	%	—
Weighted average fair value of options granted	\$ 0.36		\$ 0.36 – 0.38

During the six months ended June 30, 2014 the Company granted 85,000 options to consultants that resulted in \$6,161 in expenses this quarter. During the same period, 127,000 options were granted to employees, resulting in \$9,205 in expenses this quarter. Options granted in previous quarters resulted in additional expenses in the amount of \$1,871 for consultants and \$3,456 for employees during the quarter ended June 30, 2014. No stock options were exercised during the period.

During the six months ended June 30, 2013 the Company granted 55,000 options to consultants that resulted in \$10,030 in expenses this quarter. During the same period, 128,000 options were granted to employees, resulting in \$9,674 in expenses this quarter. Options granted in previous quarters resulted in additional expenses in the amount of \$3,609 for consultants and \$6,437 for employees during the quarter ended June 30, 2013. No stock options were exercised during the period.

11. Capital Stock.

There was no stock activity for the six months ended June 30, 2014.

12. Segmented, Significant Customer Information and Economic Dependency.

The Company operates in two segments:

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

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

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

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

Six months ended June 30, 2014:

	EWCP	BPCA	Total
Revenue	\$358,703	\$7,741,009	\$8,099,712
Interest revenue	0	0	0
Interest expense	22,010	30,762	52,772
Depreciation and amortization	231,328	94,558	325,886
Segment profit (loss)	(930,663)	1,174,838	244,175
Segment assets	4,012,578	1,657,349	5,669,927
Expenditures for segment assets	6,199	9,991	16,190

Six months ended June 30, 2013:

	EWCP	BPCA	Total
Revenue	\$503,703	\$8,885,461	\$9,389,164
Interest revenue	0	0	0
Interest expense	24,938	30,942	55,880
Depreciation and amortization	546,806	109,680	656,486
Segment profit (loss)	(1,492,301)	1,627,630	135,329
Segment assets	4,657,366	1,851,596	6,508,962
Expenditures for segment assets	55,487	-	55,487

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

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Canada	\$332,248	\$513,294
United States and abroad	7,767,464	8,875,870
Total	\$8,099,712	\$9,389,164

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

	June 30, 2014	December 31, 2013
Canada	\$4,012,578	\$4,258,075
United States	1,657,349	1,741,916
Total	\$5,669,927	\$5,999,991

Three customers accounted for \$5,032,361 (62%) of sales made during the six months ended June 30, 2014 (2013 - \$5,642,839 or 60%).

13. Commitments.

The Company is committed to minimum rental payments for property and premises aggregating approximately \$56,814 over the term of three leases, the last expiring on September 30, 2015.

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

2014	\$45,849
2015	\$10,965

14. 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 Company's second class of products, 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. TPA's 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, 2014 are discussed below:

Six Months ended June 30, 2014

Item	Increase (I) or Decrease (D)	Reason
Sales		
EWCP products	D	The Company is unsure of the reason, but has responded with special offers to increase sales.
BPCA products	D	Agriculture sales did not recover as much from cold weather in Q1 as hoped for in Q2.
Gross Profit, as a % of sales	I	Lower oil prices reduced aspartic acid costs.
Wages	D	Reduced since Taber plant is no longer in operation.
Office and miscellaneous	D	Reduced since the Taber plant is no longer operational.
Consulting	D	Reduced since Taber plant no longer in operation.
Commissions	D	Uncommissionable sales increased against commissionable sales.

Utilities	D	Reduced since Taber plant is no longer in operation.
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Three months ended June 30, 2014

Item Sales	Increase (I) or Decrease (D)	Reason
EWCP products	D	The Company is unsure of the reason, but has responded with special offers to increase sales.
BPCA products	D	Agriculture sales did not recover as much from cold weather in Q1 as hoped for in Q2.
Gross Profit, as a % of sales	I	Lower oil prices reduced aspartic acid costs.
Wages	D	Reduced since the Taber plant no longer in operation.
Office and miscellaneous	D	Reduced since the Taber plant is no longer operational.
Consulting	D	Reduced since the Taber plant no longer in operation.
Professional fees	D	Termination of litigation resulted in reduced professional fees.
Commission	D	Uncommissionable sales increased against commissionable sales.
Utilities	D	Reduced since Taber plant is no longer in operation.

Three customers accounting for 69% of our sales during the three months ended June 30, 2014 and 62% of our sales during the six months ended June 30, 2014. The amount of revenue (all from the sale of BCPA products) attributable to each customer is shown below.

Customer	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
A	\$1,116,417	\$1,374,747	\$2,123,958	\$2,834,408
B	\$1,284,017	\$1,073,071	\$2,114,042	\$1,762,605
C	\$546,105	\$500,773	\$794,361	\$1,045,826

Customers with balances greater than 10% of our receivables as of June 30, 2014 and 2013 are shown below:

	June 30,	
	2014	2013
Company A	767,189	1,301,854
Company B	782,499	476,921

In 2007, we began construction of a plant in Taber, AB, Canada. The plant came on line during 2012 and we began depreciating the plant and related equipment effective January 2012.

The plant was designed to manufacture aspartic acid which is the major component of TPAS. Previously, we bought aspartic acid from China where the base raw material is oil. The plant uses sugar as the base raw material. We believe that using aspartic acid manufactured from sugar would reduce our raw material costs, reduce price fluctuations generated by oil prices and reduce shipping costs.

In February 2014, we suspended production of aspartic acid at our Taber plant. The suspension was due to the fact that since construction of the plant began in 2008, economic conditions in Alberta and worldwide have changed significantly. In particular, plant operating costs increased and the price of aspartic acid derived from oil is less than forecast.

Although we continue to believe in the technical and economic viability of using sugar in the aspartic acid process that we have pioneered, we are unable to fund the equipment and personnel increases needed to reach break-even levels on our own. Accordingly, a partner is required to build on the technical successes achieved to date and reach profitable production levels.

While we are actively seeking a partner to complete process development, staffing at the Taber plant has been reduced to levels needed to maintain the intellectual property and the process equipment we have developed.

We expect that the suspension of the operations at the Taber plant will save us approximately \$800,000 per year in plant operating costs and general and administrative expenses.

Other factors that will most significantly affect future operating results will be:

the sale price of crude oil which is used in the manufacture of aspartic acid we import from China. Aspartic acid is a key ingredient in our BCPA product;

activity in the oil and gas industry, as we sell our BCPA product to oil and gas companies; and

drought conditions, since we also sell our BCPA product to farmers.

Other than the foregoing we do not know of any trends, events or uncertainties that have had, or are reasonably expected to have, a material impact on our revenues or expenses.

Capital Resources and Liquidity

The Company's sources and (uses) of cash for the six months ended June 30, 2014 and 2013 are shown below:

	2014	2013
Cash provided by (used by) operations	411,937	116,589
Purchases of equipment	(16,190)	(55,487)
Advances from (repayments of) short term line of credit	(400,000)	195,000
Repayment of loans	(64,393)	(84,488)
Changes in exchange rates	(3,510)	(21,118)

The Company has sufficient cash resources to meets its future commitments and cash flow requirements for the coming year. As of June 30, 2014 working capital was \$3,608,379 (December 31, 2013 - \$3,761,310) and the Company has no substantial commitments that require significant outlays of cash over the coming fiscal year.

The Company is committed to minimum rental payments for property and premises aggregating approximately \$56,814 over the term of three leases, the last expiring on September 30, 2015.

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

2014	\$45,849
2015	\$10,965

Other than as disclosed above, the Company does not anticipate any capital requirements for the twelve months ending December 31, 2014.

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 reasonable likely to result in, its liquidity increasing or decreasing in any material way.

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

The Company does not have any commitments or arrangements from any person to provide it with any equity capital.

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

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, 2014. 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, 2014.

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, 2014. 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, 2014 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)
<u>31.1</u>	Certification of Principal Executive Officer Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*
<u>31.2</u>	Certification of Principal Financial Officer Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*
<u>32.1</u>	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.

August 14, 2014

Flexible Solutions International, Inc.

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