

FLEXIBLE SOLUTIONS INTERNATIONAL INC
Form 10-K
March 31, 2014

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended December 31, 2013

OR

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

Commission File No. 001-31540

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
(Exact name of registrant 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 Principal Executive Office)

V8T 1Z8
Zip Code

Registrant's telephone number, including Area Code: (250) 477-9969

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Stock, \$0.001 par value

Name of each exchange on which registered
NYSE MKT

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ☐

Indicate by check mark whether the registrant (1) has filed all reports 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

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
(Do not check if a smaller reporting company)			

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

As of June 30, 2013 the aggregate market value of the Company's common stock held by non-affiliates was \$5,714,892 based on the closing price for shares of the Company's common stock on the NYSE MKT for that date.

As of March 15, 2014, the Company had 13,169,991 issued and outstanding shares of common stock.

Documents incorporated by reference: None

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K for the year ended December 31, 2013 (“Annual Report”), including the Notes to Audited Consolidated Financial Statements, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, without limitation, those statements relating to development of new products, our financial condition and our ability to increase distribution of our products. Forward-looking statements can be identified by the use of forward-looking terminology, such as “may,” “will,” “should,” “expect,” “anticipate,” “estimate,” “continue,” “plans,” “intends,” or other similar terminology. These forward-looking statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is anticipated or forecasted in these forward-looking statements due to numerous factors, including, but not limited to, our ability to generate or obtain sufficient working capital to continue our operations, changes in demand for our products, the timing of customer orders and deliveries and the impact of competitive products and pricing. In addition, such statements could be affected by general industry and market conditions and growth rates, and general domestic and international economic conditions.

Although we believe that the expectations reflected in these forward-looking statements are reasonable and achievable, such statements involve risks and uncertainties and no assurance can be given that our actual results will be consistent with these forward-looking statements. Except as otherwise required by applicable securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason, after the date of this Annual Report.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

We were incorporated as Flexible Solutions, Ltd., a British Columbia corporation on January 26, 1991. On May 12, 1998, we merged Flexible Solutions Ltd. into Flexible Solutions International, Inc., a Nevada corporation. In connection with this merger, we issued 7,000,000 shares of common stock to the former shareholders of Flexible Solutions Ltd. in exchange for all of the outstanding shares of Flexible Solutions Ltd.

In June 2004 we purchased 52 U.S. and 139 International patents, as well as a 56,780 sq. ft. manufacturing plant near Chicago, Illinois from the bankruptcy estate of Donlar Corporation (“Donlar”) for \$6.15 million. The patents we acquired from Donlar relate to water-soluble chemicals (“TPAs”) which prevent corrosion and scaling in water pipes used in the petroleum, chemical, utility and mining industries. TPAs are also used to enhance fertilizers and improve crop yields and as additives for household laundry detergents, consumer care products and pesticides.

We operate through a number of wholly-owned subsidiaries which are mentioned in Note 1 to the consolidated financial statements included as part of this report. Unless otherwise indicated, all references to our business include the operations of these subsidiaries.

Our website is www.flexiblesolutions.com

Our Products

HEATSAVR®/ECOSAVR

Our studies indicate that approximately 70% of the energy lost from a swimming pool occurs through water evaporation. HEATSAVR® is a chemical product for use in swimming pools and spas that 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. We have received reports from our commercial customers documenting energy savings of between \$2,400 to \$6,000 per year when using HEATSAVR®.

ECOSAVR® is a patented, disposable dispenser designed for the residential pool and spa market. ECOSAVR® is made of molded plastic in the form of a ten-inch long colorful fish that is filled with enough HEATSAVR® to cover the surface of a 400 sq. ft. swimming pool for about one month. The HEATSAVR® solution inside the ECOSAVR® escapes into the water and rises to the surface to form a transparent layer on the water’s surface. Once the ECOSAVR® is empty the dispenser is removed and replaced.

In outdoor pools, the HEATSAVR® also provides convenience compared to pool blankets. Pool blankets are plastic covers which are cut to the size and shape of the surface of the pool or spa. Pool blankets float on the surface and, like the HEATSAVR®, reduce energy costs by inhibiting water evaporation. However, it is often inconvenient to use conventional pool blankets because a pool blanket must be removed and stored before the pool can be used. Pool blankets do not provide any energy savings when not on the pool. Conversely, HEATSAVR® eliminates the need to install, remove and store the blanket and works 24 hours a day. In addition, the use of HEATSAVR® in an indoor pool results in even greater energy savings since indoor pool locations use energy not only to heat the pool water, but also to air condition the pool environment. By slowing the transfer of heat and water vapor from the pool to the atmosphere of the pool enclosure, less energy is required to maintain a pool at the desired temperature and there is a reduced load on the air-conditioning system.

HEATSAVR® retails for between \$250 and \$300 per four gallon case in the United States. ECOSAVR® has a suggested retail price of \$11.99 in the United States. We market our HEATSAVR® and ECOSAVR® products to homeowners with swimming pools and spas as well as operators of swimming pools and spas in hotels, motels, schools, and municipal and private recreational facilities.

We also manufacture and sell products which automatically dispense HEATSAVR® into commercial size swimming pools or spas at the rate of one ounce per 400 sq. ft. of water surface per day.

We have 18 non-exclusive distributorships in Canada and the United States for the sale of bulk HEATSAVR® (without the ECOSAVR® dispenser) and exclusive distributorships in Australia, Chile, Korea, Argentina, South Africa, Taiwan, and parts of Eastern and Western Europe. We support our distributors and seek additional market opportunities by annually attending the major pool industry trade shows in the United States. We also advertise in trade magazines and maintain a website which has information about our products.

WATERSAVR®

This product utilizes our HEATSAVR technology to reduce water evaporation in reservoirs, potable water storage tanks, livestock watering ponds, aqueducts, canals and irrigation ditches. WATERSAVR may also be used for lawn and turf care and potted and bedding plants.

WATERSAVR® is sold in granulated form and can be applied by hand, by fully automated scheduled metering, or by an automatic dispenser.

Tests have indicated that WATERSAVR®:

Reduces daily water evaporation as much as 54%
Reduces monthly water evaporation as much as 37%
Is odorless
Has no effect on invertebrates or vertebrates
Has no anticipated effect on any current drinking water treatment processes and
Is biodegradable

We have one full-time employee and one part-time employee who are involved in the sales and marketing of WATERSAVR®.

TPAs (thermal polyaspartate biopolymers)

TPAs for Oilfields. TPAs are used to reduce scale and corrosion in various “topside” water systems. They are used in place of traditional phosphate and other products when biodegradability is required by environmental regulations. We have the ability to custom manufacture TPAs depending on the specific water conditions associated with any oil well.

TPAs for the Agricultural Industry. TPAs have the ability to reduce fertilizer crystallization before, during and after application and can also prevent crystal formation between fertilizer and minerals present in the soil. Once crystallized, fertilizer and soil minerals are not able to provide plant nourishment. As a result, in select conditions the use of TPAs either blended with fertilizer or applied directly to crops can increase yields significantly. TPAs are designated for crop nutrient management programs and should not be confused with crop protection and pesticides or other agricultural chemical applications. Depending on the application, TPA products are marketed under a variety of brands including Amisorb, LYNX, MAGNET, AmGro and VOLT. Markets of significance include potatoes, sugar beets, cotton, tomatoes, almonds and other high value per acre crops.

TPAs for Irrigation. The crystallization prevention ability of TPAs can also be useful in select irrigation conditions. By reducing calcium carbonate scale propagation, TPAs can prevent early plugging of drip irrigation ports, reduce maintenance costs and lengthen the life of equipment. TPAs compete with acid type scale removers, but have the advantage of a positive yield effect on the plant, as well as an easier deployment formulation with liquid fertilizers when used as part of a “fertigation” program. Our TPAs for drip irrigation scale prevention are at an early stage of commercialization and will be marketed and sold through the same channels as TPAs used by the agricultural industry.

TPAs for Detergent. In detergents, TPAs are a biodegradable substitute for poly-acrylic acid. In select markets, the use of this substitute outweighs the added cost of TPAs, which has allowed for the continued growth of this TPA product line. However, to increase penetration of this market beyond specialty detergent manufacturers, we will need to decrease the cost of this product or wait for legislative intervention regarding biodegradability of detergent components. In the meantime, we are researching various methods to reduce production costs.

TPAs for Personal Care Products. TPAs can also be used in shampoo and cosmetic products for increased hydration that improves the feel of the core product to consumers. TPA’s may also be used as an additive to toothpaste with the documented effect of reducing decay bacteria adhesion to tooth enamel and presumed reduction in total decay. We do not currently sell TPAs for use in personal care products.

Principal Customers

The table below presents the percentages of our revenue resulting from purchases by our major customers for the periods presented.

	Year Ended December 31,	
	2013	2012
Company A	\$ 4,540,673	\$ 4,422,689
Company B	\$ 3,489,774	\$ 3,333,024
Company C	\$ 1,854,154	\$ 1,956,944

Customers with balances greater than 10% of our receivable balances as of each of the fiscal year ends presented are shown in the following table:

	Year Ended December 31,	
	2013	2012
Company A	\$ 820,266	\$ 1,222,797
Company B	\$ 534,868	\$ 318,920
Company D*	-	\$ 106,532
Company E*	\$ 118,548	-

* less than 10%

Competition

HEATSAVR® and ECOSAVR™

We are aware of two other companies that manufacture products that compete with HEATSAVR® and ECOSAVR® and we believe our products are more effective and safer. We maintain fair pricing equal to or lower than our competitors and protect our intellectual property carefully. Our products are expected to maintain or increase market share in the competitive pool market.

HEATSAVR® also competes with plastic pool blanket products. However, we believe that HEATSAVR® is more effective and convenient than pool blankets.

WATERSAVR®

Ultimate Products (Aust) Pty Ltd. of Australia has a product called Aquatain that directly competes with WATERSAVR®. We believe our WATERSAVR® product is superior for the following reasons: it is safer, much less expensive and has much better test data. Aquatain has not expended the capital to test for environmental effects on insects and other aquatic life whereas WATERSAVR® has recognized third party environmental safety documentation.

As water conservation is an important priority throughout the world, numerous researchers are working to develop solutions that may compete with, or be superior to, WATERSAVR.

TPAs

Our TPA products have direct competition with Lanxess AG (spun out of Bayer AG), a German manufacturer of TPAs, which uses a patented process different from ours. We have cross-licensed each other's processes and either company can use either process for the term of the patents involved. We believe that Lanxess has approximately the same production capacity and product costs as we do. We believe that we can compete effectively with Lanxess by offering excellent customer service in oilfield sales, superior distributor support in the agricultural marketplace and flexibility due to our relative size. In addition, we intend to continue to seek market niches that are not the primary targets of Lanxess.

Our TPA products face indirect competition from other chemicals in every market in which we are active. For purposes of oilfield scale prevention, phosphonates, phosphates and molibdonates provide the same effect. For crop enhancement, increased fertilizer levels or reduced concentrations can serve as a substitute for TPAs. In irrigation scale control, acid washes are our prime competitor. In detergent, poly-acrylic acid is most often used due to price advantage. Notwithstanding the above, we believe our competitive advantages include:

- Biodegradability compared to competing oil field chemicals;
- Cost-effectiveness for crop enhancement compared to increased fertilizer use;
- Environmental considerations, ease of formulation and increased crop yield opportunities in irrigation scale markets;
- and
- Biodegradability compared to poly-acrylic acid for detergents.

Manufacturing

Our HEATSAVR® and ECOSAVR® products and dispensers are made from chemicals, plastic and other materials and parts that are readily available from multiple suppliers. We have never experienced any shortage in the availability of raw materials and parts for these products and we do not have any long term supply contracts for any of these items. We manufacture these products in our plant in Taber, Alberta, Canada.

Our WATERSAVR® products are manufactured by a third party. We are not required to purchase any minimum quantity of this product.

Our 56,780 sq. ft. facility in Peru, Illinois manufactures our TPA products. Raw materials for TPA production are sourced from various manufacturers throughout the world and we believe they are available in sufficient quantities for any increase in sales. Raw materials are, however, derived from crude oil and are subject to price fluctuations related to world oil prices.

In November 2007, we purchased a building and 3.3 acres of land in Taber, Alberta, Canada. The price paid was CDN\$1,325,000 and was financed by cash of \$660,000 and an interest free mortgage that was paid in June 2008. The building operates as a fermentation facility for the production of aspartic acid, a key ingredient in TPAs. Aspartic acid made in Taber is shipped to our plant in Illinois for finishing.

Government Regulations

HEATSAVR® and ECOSAVR®

Chemical products for use in swimming pools are covered by a variety of governmental regulations in all countries where we sell these products. These regulations cover packaging, labeling, and product safety. We believe our products are in compliance with these regulations.

WATERSAVR®

Our WATERSAVR® product is subject to regulation in most countries, particularly for agricultural and drinking water uses. We do not anticipate that governmental regulations will be an impediment to marketing WATERSAVR® because the components in WATERSAVR® have historically been used in agriculture for many years for other purposes. Nevertheless, we will need to obtain approval to sell WATERSAVR® in the United States for agricultural and drinking water uses. We have received National Sanitation Foundation approval for the use of WATERSAVR® in drinking water in the United States.

TPAs

In the oil field and agricultural markets we have received government approval for all TPAs currently sold. In the detergent market, there are currently no regulatory requirements for use of TPAs in detergent formulations. For personal care products such as shampoo and toothpaste, there are various regulatory bodies, including the National Sanitation Foundation and the United States Food and Drug Administration, which regulate TPA use. If we begin to market our TPA products for personal care use, we will need to satisfy applicable regulatory requirements.

Proprietary Rights

Our success is dependent, in part, upon our proprietary technology. We rely on a combination of patent, copyright, trademarks, trade secrets and nondisclosure agreements to protect our proprietary technology. We currently hold many U.S. patents and International patents which expire at various dates up to 2032. We also have applied to extend some of these patents to other countries where we operate. There can be no assurance that our foreign patent applications will be granted or that any issued patent will be upheld as valid or prevent the development of competitive products, which may be equivalent to or superior to our products. We have not received any claims alleging infringement of the intellectual property rights of others, but there can be no assurance that we may not be subject to such claims in the future.

Research and Development

We spent \$123,772 during the year ended December 31, 2013 and \$68,254 during year ended December 31, 2012 on research and development. This work relates primarily to the development of our water and energy conservation products, as well as new research in connection with our TPA products.

Employees

As of December 31, 2013 we had 39 employees, including one officer, eleven sales and customer support personnel, and twenty two manufacturing personnel. None of our employees is represented by a labor union and we have not experienced any work stoppages to date.

ITEM 1A. RISK FACTORS

This Form 10-K contains forward-looking information based on our current expectations. Because our actual results may differ materially from any forward-looking statements made by us, this section includes a discussion of important factors that could affect our future operations and result in a decline in the market price of our common stock.

We have incurred significant operating losses since inception and may not sustain profitability in the future.

We have experienced operating losses and negative cash flow from operations and we currently have an accumulated deficit. If our revenues do not increase, our results of operations and liquidity may be materially adversely affected. If we experience slower than anticipated revenue growth or if our operating expenses exceed our expectations, we may not be profitable. Even if we become profitable in the future, we may not remain profitable.

Fluctuations in our operating results may cause our stock price to decline.

Given the nature of the markets in which we operate, we cannot reliably predict future revenues and profitability. Changes in competitive, market and economic conditions may cause us to adjust our operations. A high proportion of our costs are fixed, due in part to our sales, research and development and manufacturing costs. Thus, small declines in revenue could disproportionately affect our operating results. Factors that may affect our operating results and the market price of our common stock include:

- demand for and market acceptance of our products;
- competitive pressures resulting in lower selling prices;

adverse changes in the level of economic activity in regions in which we do business;
adverse changes in the oil and gas industry on which we are particularly dependent;
changes in the portions of our revenue represented by various products and customers;
delays or problems in the introduction of new products;
the announcement or introduction of new products, services or technological innovations by our competitors;
variations in our product mix;
the timing and amount of our expenditures in anticipation of future sales;
increased costs of raw materials or supplies; and
changes in the volume or timing of product orders.

Our operations are subject to seasonal fluctuation.

The use of our swimming pool products increases in summer months in most markets and results in our sales from January to June being greater than in July through December. Markets for our WATERSAVR® product are also seasonal, depending on the wet versus dry seasons in particular countries. We attempt to sell into a variety of countries with different seasons on both sides of the equator in order to minimize seasonality. Our TPA business is the least seasonal, however there is a small increase in the spring related to inventory building for the crop season in the United States and a small slowdown in December as oilfield customers run down stock in advance of year end, but otherwise, little seasonal variation. We believe we are able to adequately respond to these seasonal fluctuations by reducing or increasing production as needed.

Interruptions in our ability to purchase raw materials and components may adversely affect our profitability.

We purchase certain raw materials and components from third parties pursuant to purchase orders placed from time to time. Because we do not have guaranteed long-term supply arrangements with our suppliers, any material interruption in our ability to purchase necessary raw materials or components could have a material adverse effect on our business, financial condition and results of operations.

Our WATERSAVR® product has not proven to be a revenue producing product and we may never recoup the cost associated with its development.

The marketing efforts of our WATERSAVR® product may result in continued losses. We introduced our WATERSAVR® product in June 2002 and, to date, we have delivered quantities for testing by potential customers, but only a few customers have ordered the product for commercial use. This product can achieve success only if it is ordered in substantial quantities by commercial customers who have determined that the water saving benefits of the product exceed the costs of purchase and deployment of the product. We can offer no assurance that we will receive sufficient orders of this product to achieve profits or cover the additional expenses incurred to manufacture and market this product. We expect to spend \$200,000 on the marketing and production of our WATERSAVR® product in fiscal 2014.

If we do not introduce new products in a timely manner, our products could become obsolete and our operating results would suffer.

Without the timely introduction of new products and enhancements, our products could become obsolete over time, in which case our revenue and operating results would suffer. The success of our new product offerings will depend upon several factors, including our ability to:

- accurately anticipate customer needs;
- innovate and develop new products and applications;
- successfully commercialize new products in a timely manner;
- price our products competitively and manufacture and deliver our products in sufficient volumes and on time; and
- differentiate our products from our competitors' products.

In developing any new product, we may be required to make a substantial investment before we can determine the commercial viability of the new product. If we fail to accurately foresee our customers' needs and future activities, we may invest heavily in research and development of products that do not lead to significant revenues.

We are dependent upon certain customers.

Among our current customers, we have identified three that are sizable enough that the loss of any one would be significant. Any loss of one or more of these customers could result in a substantial reduction in our revenues.

Economic, political and other risks associated with international sales and operations could adversely affect our sales.

Revenues from shipments made outside of the United States accounted for approximately 73% of our revenues in the year ended December 31, 2013, 73% in the year ended December 31, 2012 and 73% in the year ended December 31, 2011. Since we sell our products worldwide, our business is subject to risks associated with doing business internationally. We anticipate that revenues from international operations will continue to represent a sizable portion of our total revenue. Accordingly, our future results could be harmed by a variety of factors, including:

- changes in foreign currency exchange rates;
- changes in a country or region's political or economic conditions, particularly in developing or emerging markets;
- longer payment cycles of foreign customers and difficulty of collecting receivables in foreign jurisdictions;
- trade protection measures and import or export licensing requirements;
- differing tax laws and changes in those laws;
- difficulty in staffing and managing widespread operations;
- differing laws regarding protection of intellectual property; and
- differing regulatory requirements and changes in those requirements.

We are subject to credit risk and may be subject to substantial write-offs if one or more of our significant customers default on their payment obligations to us.

We currently allow our major customers between 30 and 45 days to pay for each sale. This practice, while customary, presents an accounts receivable write-off risk in that if one or more of our significant customers defaulted on their payment obligations to us, such write-off, if substantial, would have a material adverse effect on our business and results of operations.

Our products can be hazardous if not handled, stored and used properly; litigation related to the handling, storage and safety of our products would have a material adverse effect on our business and results of operations.

Some of our products are flammable and must be stored properly to avoid fire risk. Additionally, some of our products may cause irritation to a person's eyes if they are exposed to the concentrated product. Although we label our products to warn of such risks, our sales could be reduced if our products were considered dangerous to use or if they are implicated in causing personal injury or property damage. We are not currently aware of any circumstances in which our products have caused harm or property damage to consumers. Nevertheless, litigation regarding the handling, storage and safety of our products would have a material adverse effect on our business and results of operations.

Our failure to comply with environmental regulations may create significant environmental liabilities and force us to modify our manufacturing processes.

We are subject to various federal, state and local environmental laws, ordinances and regulations relating to the use, storage, handling and disposal of chemicals. Under such laws, we may become liable for the costs of removal or remediation of these substances that have been used by our consumers or in our operations. Such laws may impose liability without regard to whether we knew of, or caused, the release of such substances. Any failure by us to comply with present or future regulations could subject us to substantial fines, suspension of production, alteration of manufacturing processes or cessation of operations, any of which could have a material adverse effect on our business, financial condition and results of operations.

Our failure to protect our intellectual property could impair our competitive position.

While we own certain patents and trademarks, some aspects of our business cannot be protected by patents or trademarks. Accordingly, in these areas there are few legal barriers that prevent potential competitors from copying certain of our products, processes and technologies or from otherwise entering into operations in direct competition with us. In particular, we have been informed that our former exclusive agent for the sale of our products in North America is now competing with us in the swimming pool and personal spa markets. As a former distributor, they were given access to many of our sales, marketing and manufacturing techniques. Our products may infringe on the intellectual property rights of others, and resulting claims against us could be costly and prevent us from making or selling certain products.

Third parties may seek to claim that our products and operations infringe their patents or other intellectual property rights. We may incur significant expense in any legal proceedings to protect our proprietary rights or to defend infringement claims by third parties. In addition, claims of third parties against us could result in awards of substantial damages or court orders that could effectively prevent us from making, using or selling our products in the United States or abroad.

A claim for damages could materially and adversely affect our financial condition and results of operations.

Our business exposes us to potential product liability risks, particularly with respect to our consumer swimming pool and consumer TPA products. There are many factors beyond our control that could lead to liability claims, including the failure of our products to work properly and the chance that consumers will use our products incorrectly or for purposes for which they were not intended. There can be no assurance that the amount of product liability insurance that we carry will be sufficient to protect us from product liability claims. A product liability claim in excess of the amount of insurance we carry could have a material adverse effect on our business, financial condition and results of operations.

Our ongoing success is dependent upon the continued availability of certain key employees.

Our business would be adversely affected if the services of Daniel B. O'Brien ceased to be available to us because we currently do not have any other employee with an equivalent level of expertise in and knowledge of our industry. If Mr. O'Brien no longer served as our President and Chief Executive Officer, we would have to recruit one or more new executives, with no real assurance that we would be able to engage a replacement executive with the required skills on satisfactory terms. The market for skilled employees is highly competitive, especially for employees in the fields in which we operate. While our compensation programs are intended to attract and retain qualified employees, there can be no assurance that we will be able to retain the services of all our key employees or a sufficient number to execute our plans, nor can there be any assurances that we will be able to continue to attract new employees as required.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

ITEM 2. PROPERTIES.

We lease 4,300 sq. ft. in Victoria, British Columbia that was used for administration and sales and research at \$6,639 per month, effective to June 2014, as well a 1,100 sq ft. that is currently being used for administration and sales at \$1,220 per month, effective to October 2015. We also have a 7,000 sq. ft. in Bedford Park, Illinois for offices and laboratories at a cost of \$7,941 per month with a year to year lease. We own a 56,780 sq. ft. facility in Peru, Illinois which is used to manufacture our TPA line of products as well as a building and 3.3 acres of land in Taber, Alberta, Canada. Our building in Taber has been renovated and operates as a fermentation facility for the production of aspartic acid, a key ingredient in TPAs. Aspartic acid made in Taber is shipped to Illinois for finishing as well as for manufacturing our swimming pool products. Subsequent to December 31, 2013, the Company decided to stop production at the Taber facility until a partner could be found to help fund operations to profitable levels of production. This decision is detailed in our news release of February 25, 2014.

ITEM 3. LEGAL PROCEEDINGS.

None.

ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASE OF EQUITY SECURITIES.

Our common stock is traded on the NYSE MKT under the symbol "FSI". The following is the range of high and low closing prices for our common stock for the periods indicated:

		High	Low
Year Ended December 31, 2013			
	First Quarter	\$ 1.52	\$ 1.00
	Second Quarter	1.22	0.71
	Third Quarter	1.35	0.78
	Fourth Quarter	1.16	0.76
		High	Low
Year Ended December 31, 2012			
	First Quarter	\$ 2.61	\$ 1.97
	Second Quarter	2.45	1.21
	Third Quarter	1.45	1.07
	Fourth Quarter	1.72	1.02

As of December 31, 2013 we had approximately 1,700 shareholders.

Our common stock also trades on the Frankfurt stock exchange under the symbol "FXT."

We have not paid any dividends on our common stock and it is not anticipated that any dividends will be paid in the foreseeable future. Our board of directors intends to follow a policy of retaining earnings, if any, to finance our growth. The declaration and payment of dividends in the future will be determined by our directors in light of conditions then existing, including our earnings, financial condition, capital requirements and other factors.

None of our officers or directors, nor any of our principal shareholders purchased, on our behalf, any shares of our common stock from third parties either in a private transaction or as a result of purchases in the open market during the years ended December 31, 2012 and 2013.

As of March 15, 2014 we had 13,169,991 outstanding shares of common stock. The following table lists additional shares of our common stock, including shares issuable upon the exercise of options which have not yet vested, which may be issued as of March 15, 2014:

	Number Of Shares	Note Reference
Shares issuable upon exercise of options granted to our officers, directors, employees, consultants, and third parties	1,164,000	A

A. Options are exercisable at prices ranging from \$1.21 to \$2.45 per share. See Item 11 of this report for more information concerning these options.

ITEM 6. SELECTED FINANCIAL DATA.

Not applicable.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.

Results of Operations

We have two product lines.

The first is a chemical ("EWCP") 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 thereby reducing the energy required to maintain the desired temperature of the water. A modified version of EWCP can also be used in reservoirs, potable water storage tanks, livestock watering pods, canals, and irrigation ditches for the purpose of reducing evaporation.

The second product, biodegradable polymers ("TPAs"), is used by the petroleum, chemical, utility and mining industries to prevent corrosion and scaling in water piping. TPAs can also be used to increase biodegradability in detergents and in the agriculture industry to increase crop yields by enhancing fertilizer uptake.

Material changes in line items in our Statement of Operations for the year ended December 31, 2013 as compared to the same period last year, are discussed below:

Item	Increase (I) or Decrease (D)	Reason
Sales		
EWCP products	D	Increased orders in the previous periods contributed to decreased orders in this period.
BPCA products	D	The European economic situation pressured sales for the period.
Gross Profit, as a % of sales	D	Start of production at Taber plant increased depreciation; high oil prices increased aspartic acid costs.
Office and miscellaneous	I	Construction costs allocated to operating costs now that the Taber plant is operational.
Professional fees	D	Reduced litigation resulted in reduced professional fees.
Research	I	Research into and regulatory compliance for potential new products increased as products near commercial sales.
Commissions	D	Uncommissionable sales increased against commissionable sales.

The 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

Our material sources and <uses> of cash during the year ended December 31, 2013 were:

Cash provided by operations	\$479,959
Equipment purchases, primarily related to our new facility in Alberta, Canada	(235,565)
Borrowing from short term line of credit	195,000
Repayment of loans	(327,145)
Exchange rate changes	91,250
Other	2,721

Our material sources and <uses> of cash during the year ended December 31, 2012 were:

Cash used in operations	\$(307,246)
Equipment purchases, primarily related to our new facility in Alberta, Canada	(96,721)
Borrowing from short term line of credit	555,000
Repayment of loans	(293,397)
Exchange rate changes	(2,672)
Cash on hand at beginning of period	(145,036)

In 2007, we began construction of a plant in Taber Alberta. The plant came on line during 2012 and we began depreciating the plant and related equipment effective January 2012. This resulted in a significant increase in depreciation expense as shown on our statement of cash flows for year ended December 31, 2012.

During the year ended December 31, 2012 inventories increased due to production at our newly opened plant in Alberta.

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 have risen and the price of aspartic acid derived from oil are less than forecast.

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

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.

We have sufficient cash resources to meets our future commitments and cash flow requirements for the coming year. As of December 31, 2013 our working capital was \$3,554,110 and we have no substantial commitments that require significant outlays of cash over the coming fiscal year.

We are committed to minimum rental payments for property and premises aggregating approximately \$149,944 over the term of three leases, the last expiring on September 30, 2015.

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

2014	\$ 138,944
2015	\$ 11,000

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

Other than as disclosed in Item 7 of this report, we do not know of any trends, demands, commitments, events or uncertainties that will result in, or that are reasonable likely to result in, our liquidity increasing or decreasing in any material way.

Other than as disclosed in Item 7 of this report, we do not know of any significant changes in our expected sources and uses of cash.

We do not have any commitments or arrangements from any person to provide us with any equity capital.

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

Critical Accounting Policies And Estimates

Allowances for Product Returns. We grant certain of our customers the right to return product which they are unable to sell. Upon sale, we evaluate the need to record a provision for product returns based on our historical experience, economic trends and changes in customer demand.

Allowances for Doubtful Accounts Receivable. We evaluate our accounts receivable to determine if they will ultimately be collected. This evaluation includes significant judgments and estimates, including an analysis of receivables aging and a review of large accounts. If, for example, the financial condition of a customer deteriorates resulting in an impairment of its ability to pay or a pattern of late payment develops, an allowance may be required.

Provisions for Inventory Obsolescence. We may need to record a provision for estimated obsolescence and shrinkage of inventory. Our estimates would consider the cost of inventory, the estimated market value, the shelf life of the inventory and our historical experience. If there are changes to these estimates, provisions for inventory obsolescence may be necessary.

Recent Accounting Pronouncements

We have evaluated recent accounting pronouncements issued since January 1, 2013 and determined that the adoption of this recent accounting pronouncements will not have a material effect on our financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC. AND SUBSIDIARIES

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<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2013 and 2012</u>	F-4
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of FLEXIBLE SOLUTIONS INTERNATIONAL, INC.:

We have audited the accompanying consolidated balance sheets of Flexible Solutions International Inc. (the “Company”) as of December 31, 2013 and 2012, and the related consolidated statements of operations, stockholders’ equity and cash flows for each of the years in the two year period ended December 31, 2013. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the years in the two period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America.

Vancouver, Canada
March 31, 2014

MNP LLP, Chartered Accountants

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.

Consolidated Balance Sheets

As at December 31

(U.S. Dollars)

	2013	2012
Assets		
Current		
Cash and cash equivalents	\$568,087	\$361,867
Accounts receivable (see Note 3)	2,012,115	2,199,359
Inventories (see Note 4)	3,061,536	3,361,760
Prepaid expenses	126,952	127,009
Total current assets	5,768,690	6,049,995
Property, equipment and leaseholds, net (see Note 5)	5,831,123	7,185,730
Patents (see Note 6)	168,868	200,512
Long term deposits (see Note 7)	4,781	7,893
Deferred tax asset (see Note 10)	2,700,506	292,111
Total Assets	\$14,473,968	\$13,736,241
Liabilities		
Current		
Accounts payable and accrued liabilities	\$570,476	\$677,969
Deferred revenue	13,550	312,556
Income taxes payable	(281,202)	45,998
Short term line of credit (Note 8)	1,400,000	1,205,000
Current portion of long term debt (see Note 9)	304,556	318,644
Total current liabilities	2,007,380	2,560,167
Long term debt (see Note 9)	993,274	1,407,406
Total liabilities	3,000,654	3,967,573
Stockholders' Equity		
Capital stock (see Note 13)		
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 (2012: 13,169,991) common shares	13,170	13,170
Capital in excess of par value	16,135,953	16,006,798
Other comprehensive income	328,686	574,829
Accumulated Deficit	(5,004,495)	(6,826,129)
Total Stockholders' Equity	11,473,314	9,768,668

Total Liabilities and Stockholders' Equity	\$14,473,968	\$13,736,241
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Commitments, Contingencies and Subsequent events (See Notes 15, 16 and 17)

See Notes to Consolidated Financial Statements.

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.

Consolidated Statements of Operations and Comprehensive Income (Loss)

For the Years Ended December 31

(U.S. Dollars)

	2013	2012
Sales	\$15,801,596	\$16,400,107
Cost of sales	11,271,200	11,127,742
Gross profit	4,530,396	5,272,365
Operating Expenses		
Wages	1,795,564	1,729,768
Administrative salaries and benefits	801,087	792,927
Advertising and promotion	25,053	63,884
Investor relations and transfer agent fee	221,407	224,873
Office and miscellaneous	760,264	504,312
Insurance	290,224	288,727
Interest expense	109,199	128,407
Rent	191,423	182,056
Consulting	316,688	296,643
Professional fees	330,515	523,057
Travel	123,861	142,139
Telecommunications	31,457	30,605
Shipping	25,456	39,301
Research	123,772	68,254
Commissions	122,952	166,855
Bad debt expense	37,659	(319)
Currency exchange	(4,460)	(9,694)
Utilities	122,639	134,637
Total operating expenses	5,424,760	5,306,432
Operating income	(894,364)	(34,067)
Exclusive distributor fee	250,000	
Write down of inventory	(81,174)	-
Gain on sale of equipment	2,057	2,217
Interest income	2,000	759
Income before income tax	(721,481)	(31,091)
Income taxes (Note 10)		
Deferred income tax recovery	2,408,395	73,111
Income tax recovery (expense)	134,720	(1,126,468)
Net income (loss) for the year	\$1,821,634	\$(1,084,448)

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Other comprehensive income (loss)	(246,143)	97,690
Comprehensive income (loss)	1,575,491	(986,757)
Income (loss) per share (basic and diluted)	\$0.14	\$(0.08)
Weighted average number of common shares (basic and diluted)	13,169,991	13,169,991

See Notes to Consolidated Financial Statements.

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.

Consolidated Statements of Cash Flows

For Years Ended December 31

(U.S. Dollars)

	2013	2012
Operating activities		
Net income (loss)	\$1,821,634	\$(1,084,448)
Adjustments to reconcile net loss to net cash:		
Stock based compensation	129,155	142,450
Write down of inventory	81,174	-
Depreciation	1,298,616	1,256,238
Deferred tax recovery	(2,408,395)	(73,111)
Changes in non-cash working capital items:		
(Increase) Decrease in accounts receivable	91,567	135,462
(Increase) Decrease in inventories	187,448	(459,250)
(Increase) Decrease in prepaid expenses	(4,223)	9,745
Increase (Decrease) in accounts payable	(91,512)	157,668
Increase (Decrease) in taxes payable	(327,200)	(392,000)
Increase (Decrease) deferred revenue	(298,305)	-
Cash provided by (used in) operating activities	479,959	(307,246)
Investing activities		
Proceeds from disposal of long term deposits	2,721	-
Acquisition of equipment	(235,565)	(96,721)
Cash provided by (used in) investing activities	(232,844)	(96,721)
Financing activities		
Proceeds from short term line of credit	195,000	555,000
Proceeds from long term debt	(327,145)	(293,397)
Cash provided by (used in) financing activities	(132,145)	261,603
Effect of exchange rate changes on cash	91,250	(2,672)
Inflow (outflow) of cash	206,220	(145,036)
Cash and cash equivalents, beginning	361,867	506,903
Cash and cash equivalents, ending	\$568,087	\$361,867
Supplemental disclosure of cash flow information:		
Income taxes paid	204,480	1,523,567
Interest paid	110,194	128,407

See Notes to Consolidated Financial Statements.

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
Consolidated Statements of Stockholders' Equity
For the Years Ended December 31, 2013 and 2012
(U.S. Dollars)

	Shares	Par Value	Capital in Excess of Par Value	Accumulated Earnings (Deficiency)	Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance December 31, 2011	13,169,991	\$ 13,170	\$ 15,864,348	\$ (5,741,681)	\$ 477,139	\$ 10,612,976
Translation adjustment	—	—	—	—	97,690	97,690
Net loss	—	—	—	(1,084,448)	—	(1,084,448)
Comprehensive income	—	—	—	—	—	(986,758)
Stock-based compensation	—	—	142,450	—	—	142,450
Balance December 31, 2012	13,169,991	\$ 13,170	\$ 16,006,798	\$ (6,826,129)	\$ 574,829	\$ 9,768,668
Translation adjustment	—	—	—	—	(246,143)	(246,143)
Net income	—	—	—	1,821,634	—	1,821,634
Comprehensive income	—	—	—	—	—	1,575,491
Stock-based compensation	—	—	129,155	—	—	129,155
Balance December 31, 2013	13,169,991	\$ 13,170	\$ 16,135,953	\$ (5,004,495)	\$ 328,686	\$ 11,473,314

See Notes to Consolidated Financial Statements.

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(U.S. Dollars)

1. Basis of Presentation.

These consolidated financial statements include the accounts of Flexible Solutions International, Inc. (the “Company”), 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.

Flexible Solutions International, Inc. and its subsidiaries develop, manufacture and market specialty chemicals which slow the evaporation of water. One product, 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 can be used 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.

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(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.

Costs capitalized on self-constructed assets, classified as plant under construction, include contracted costs and supplies, but not capitalized interest costs. The Company has commenced depreciating its plant as construction has been completed and the plant is in use.

(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 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.

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(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 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 years ended December 31, 2013 and 2012.

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(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, and accounts payable and accrued liabilities, and short term line of credit 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.

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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 which is 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 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. 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. Legal fees associated with loss contingencies are expensed as incurred.

(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 December 31, 2013, 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.

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(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 \$1,473,682 (73%) at December 31, 2013 (2012 - \$1,648,428 or 75%).

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) Recent 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 prospectively 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

	2013	2012
Accounts receivable	\$ 2,056,964	\$ 2,212,448
Allowances for doubtful accounts	(44,849)	(13,089)
	\$ 2,012,115	\$ 2,199,359

The Company has pledged \$156,066 (2012 - \$69,410) of the above listed accounts receivable as collateral for the Flexible Solutions Ltd. loan from AFSC (see Note 9b).

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4. Inventories

	2013	2012
Completed goods	\$ 1,527,563	\$ 1,740,186
Work in progress	34,702	31,593
Raw materials	1,499,271	1,589,981
	\$ 3,061,536	\$ 3,361,760

The Company has pledged \$459,339 (2012 - \$487,903) of the above listed inventories as collateral for the Flexible Solutions Ltd. loan from AFSC (see Note 9b)

5. Property, Equipment and Leaseholds

	2013 Cost	Accumulated Depreciation	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

	2012 Cost	Accumulated Depreciation	2012 Net
Buildings	\$ 5,372,327	\$ 2,122,396	\$ 3,249,931
Computer hardware	106,457	88,811	17,646
Furniture and fixtures	28,385	22,155	6,230
Office equipment	23,946	20,795	3,151
Manufacturing equipment	6,039,836	2,725,324	3,314,512
Trailer	17,353	13,930	3,423
Technology	137,308	27,461	109,847
Truck	11,951	9,512	2,439
Land	478,551	—	478,551
	\$ 12,216,114	\$ 5,030,384	\$ 7,185,730

Amount of depreciation expense for 2013: \$1,279,255 (2012: \$1,245,114)

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The following carrying amount of property, equipment and leaseholds held by Flexible Solutions Ltd. serves as collateral for the AFSC loan (see Note 9b):

Land	\$261,413
Building	780,527
Building improvements	827,645
Manufacturing equipment	2,129,434
Trailer	2,241
Technology	77,065

6. Patents

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

	2012 Cost	Accumulated Amortization	2012 Net
Patents	\$ 266,451	\$ 65,939	\$ 200,512

Decrease in 2013 cost was due to currency conversion. 2013 cost in Canadian dollars - \$265,102 (2012 - \$265,102 in Canadian dollars).

Amount of depreciation for 2013: \$19,361 (2012: \$11,124).

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

2014	\$19,051
2015	19,051
2016	19,051
2017	19,051
2018	19,051