FLEXIBLE SOLUTIONS INTERNATIONAL INC
Form 10QSB
November 14, 2006

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

FORM 10-QSB

(Mark one)

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

For the quarterly period ended September 30, 2006.

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

For the transition period from to .

Commission File Number 000-29649

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

Nevada (State of Incorporation)	**91-1922863** (IRS Employer Identification No.)
615 Discovery Street **Victoria, British Columbia, CANADA** (Address of Principal Executive Offices)	**V8T 5G4** (Zip Code)

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: The Company had 12,998,427 shares of Common Stock, par value $0.001 per share, outstanding as of October 23, 2006.

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

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

Forward-looking statements may include the words “may,” “could,” “will,” “estimate,” “intend,” “continue,” “believe,” “expec “anticipate” or other similar words. These forward-looking statements present our estimates and assumptions only as of the date of this report. Except for our ongoing obligation to disclose material information as required by the federal securities laws, we do not intend, and undertake no obligation, to update any forward-looking statement.

Although we believe that the expectations reflected in any of our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed in any of our forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to change and inherent risks and uncertainties. The factors impacting these risks and uncertainties include but are not limited to:

- Increased competitive pressures from existing competitors and new entrants;
- Increases in interest rate or our cost of borrowing or a default under any material debt agreement;
- Deterioration in general or regional economic conditions;
- Adverse state or federal legislation or regulation that increases the costs of compliance, or adverse findings by a regulator with respect to existing operations;
- Loss of customers or sales weakness;
- Inability to achieve future sales levels or other operating results;
- The unavailability of funds for capital expenditures; and
- Operational inefficiencies in distribution or other systems.

For a detailed description of these and other factors that could cause actual results to differ materially from those expressed in any forward-looking statement, please see “Risk Factors” in our Annual Report on Form 10-KSB for the year ended December 31, 2005.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
At September 30, 2006
(U.S. Dollars)

	September 30, 2006 (Unaudited)	December 31, 2005
Assets		
Current		
Cash and cash equivalents	$ 418,425	$ 526,292
Accounts receivable	1,243,413	758,463
Income tax receivable	-	28,918
Loan receivable	36,385	35,228
Inventory	1,958,553	2,314,979
Prepaid expenses	169,628	137,315
	3,826,404	3,801,195
Property, equipment and leaseholds	4,250,682	4,657,383
Patents	154,526	143,822
Investment	369,000	369,000
	$ 8,600,612	$ 8,971,400
Liabilities		
Current		
Accounts payable and accrued liabilities	$ 283,406	$ 691,105
	283,406	691,105
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		
12,998,427 (2005: 12,981,316) common shares	12,998	12,981
Capital in excess of par value	12,038,749	11,422,219
Other comprehensive income	211,364	153,253
Deficit	(3,945,905)	(3,308,158)
Total Stockholders' Equity	8,317,206	8,280,295
Total Liabilities and Stockholders' Equity	$ 8,600,612	$ 8,971,400
Commitments and Contingencies (Notes 13 & 14)		

-- See Notes to Unaudited Consolidated Financial Statements --

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months Ended September 30, 2006 and 2005
(U.S. Dollars -- Unaudited)

	Three Months Ended September 30, 2006	2005 (Restated) See Note 3
Sales	$ 1,913,958	$ 1,302,089
Cost of sales	1,027,274	737,938
Gross profit	886,684	564,151
Operating expenses		
Wages	253,253	202,776
Administrative salaries and benefits	155,841	56,760
Advertising and promotion	3,450	17,246
Investor relations and transfer agent fee	82,676	41,897
Office and miscellaneous	29,815	57,456
Insurance	67,342	42,087
Interest expense	931	-
Rent	59,179	64,889
Consulting	94,811	26,069
Professional fees	51,564	107,257
Travel	28,729	26,318
Telecommunications	9,417	9,097
Shipping	8,251	11,272
Research	21,795	20,843
Commissions	40,206	24,161
Bad debt expense (recovery)	(234)	-
Currency exchange	752	64,653
Utilities	3,628	3,161
Depreciation	151,849	157,643
	1,063,255	933,585
Income (loss) before other items and income tax	(176,571)	(369,434)
Registration rights penalty	(326,710)	-
Interest income	832	528
Income (loss) before income tax	(502,449)	(368,906)
Income tax (recovery)	-	-
Net income (loss)	(502,449)	(368,906)
Deficit, beginning	(3,443,456)	(2,555,526)
Deficit, ending	$ (3,945,905)	$ (2,924,432)
Net income (loss) per share	$ (0.04)	$ (0.03)

Weighted average number of shares	12,987,799	12,840,446

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Nine Months Ended September 30, 2006 and 2005
(U.S. Dollars -- Unaudited)

	Nine Months Ended September 30, 2006		2005 (Restated) See Note 3	
Sales	$	6,672,791	$	5,189,803
Cost of sales		3,797,649		2,869,883
Gross profit		2,875,142		2,319,920
Operating expenses				
Wages		851,744		639,601
Administrative salaries and benefits		475,982		165,836
Advertising and promotion		35,834		61,931
Investor relations and transfer agent fee		146,009		551,486
Office and miscellaneous		127,706		126,987
Insurance		161,050		104,874
Interest expense		1,974		62,189
Rent		176,978		168,560
Consulting		290,859		117,855
Professional fees		212,438		233,708
Travel		78,217		105,185
Telecommunications		24,442		31,987
Shipping		33,835		34,308
Research		102,059		39,247
Commissions		130,196		112,159
Bad debt expense (recovery)		190		-
Currency exchange		5,277		57,786
Utilities		13,258		14,662
Depreciation		447,894		488,729
		3,315,942		3,117,090
Income (loss) before other items and income tax		(440,800)		(797,170)
Registration rights penalty		(326,710)		-
Interest income		2,684		4,145
Income (loss) before income tax		(764,826)		(793,025)
Income tax (recovery)		(127,079)		-
Net income (loss)		(637,747)		(793,025)
Deficit, beginning		(3,308,158)		(2,131,407)
Deficit, ending	$	(3,945,905)	$	(2,924,432)
Net income (loss) per share	$	(0.05)	$	(0.06)

Weighted average number of shares	12,984,028	12,446,647

-- See Notes to Unaudited Consolidated Financial Statements --

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2006 and 2005
(U.S. Dollars -- Unaudited)

	Nine Months Ended September 30, 2006	2005 (Restated) See Note 3
Operating activities		
Net income (loss)	$ (637,747)	$ (793,025)
Stock compensation expense	641,358	527,050
Depreciation	447,894	488,729
	451,505	222,754
Changes in non-cash working capital items:		
(Increase) Decrease in accounts receivable	(484,950)	(301,238)
(Increase) Decrease in income taxes	28,918	64,044
(Increase) Decrease in inventory	356,426	(755,743)
(Increase) Decrease in prepaid expenses	(32,313)	11,713
Increase (Decrease) in accounts payable	(407,699)	(44,858)
Cash provided by (used in) operating activities	(88,113)	(803,328)
Investing activities		
Short-term investments	-	559,440
Investments	-	(98,000)
Loan receivable	(1,157)	(1,157)
Development of patents	(10,704)	-
Acquisition of property and equipment	(41,193)	(130,661)
Cash provided by (used in) investing activities	(53,054)	329,622
Financing activities		
Short-term loan	-	(3,150,000)
Proceeds from issuance of common stock	(24,809)	3,426,094
Cash provided by financing activities	(24,809)	276,094
Effect of exchange rate changes on cash	58,109	132,709
Inflow (outflow) of cash	(107,867)	(64,903)
Cash and cash equivalents, beginning	526,292	558,795
Cash and cash equivalents, ending	$ 418,425	$ 493,892
Supplemental disclosure of cash flow information:		
Registration rights penalty	$ (326,710)	-
Interest received	$ 2,684	$ 528

-- See Notes to Unaudited Consolidated Financial Statements --

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FLEXIBLE SOLUTIONS INTERNATIONAL INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
For the Period Ended September 30, 2006
(U.S. Dollars)

1. Basis of Presentation.

These unaudited consolidated financial statements of Flexible Solutions International, Inc (the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. These financial statements are condensed and do not include all disclosures required for annual financial statements. The organization and business of the Company, accounting policies followed by the Company and other information are contained in the notes to the Company’s audited consolidated financial statements filed as part of the Company’s December 31, 2005 Annual Report on Form 10-KSB. This quarterly report should be read in conjunction with such annual report.

In the opinion of the Company’s management, these consolidated financial statements reflect all adjustments necessary to present fairly the Company’s consolidated financial position at September 30, 2006, and the consolidated results of operations and the consolidated statements of cash flows for the nine months ended September 30, 2006 and 2005. The results of operations for the nine months ended September 30, 2006 are not necessarily indicative of the results to be expected for the entire fiscal year.

These consolidated financial statements include the accounts of the Company, and its wholly-owned subsidiaries Flexible Solutions, Ltd. (“Flexible Ltd.”), NanoChem Solutions Inc., WaterSavr Global Solutions Inc., Nano Detect Technologies Inc., and Seahorse Systems 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, as described below.

On June 30, 1998, the Company completed the acquisition of all of the shares of Flexible Ltd. The acquisition was effected through the issuance of 7,000,000 shares of common stock by the Company, with the former shareholders of Flexible Ltd. receiving all of the shares then issued and outstanding of the Company. The transaction has been accounted for as a reverse-takeover. Flexible Ltd. is accounted for as the acquiring party and the surviving entity. As Flexible Ltd. is the accounting survivor, the consolidated financial statements presented for all periods are those of Flexible Ltd. The shares issued by the Company pursuant to the acquisition have been accounted for as if those shares had been issued upon the organization of Flexible Ltd.

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

Pursuant to a purchase agreement dated May 26, 2004, the Company acquired the assets of Donlar Corporation on June 9, 2004 and created a new company, NanoChem Solutions Inc. The purchase price of the transaction was $6,150,000, with consideration being a combination of cash and debt. Under the purchase agreement and as part of the consideration, the Company issued a promissory note bearing interest at 4% to satisfy $3,150,000 of the purchase price. This note was due June 2, 2005 and upon payment, all former Donlar assets that were pledged as security were released from their mortgage.

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

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

The acquisition costs assigned to property and equipment are all direct costs incurred by the Company to purchase the assets. These costs include due diligence fees paid to outside parties investigating and identifying the assets, legal costs directly attributable to the purchase of the assets, plus applicable transfer taxes. These costs have been assigned to the individual assets based on their proportional fair values and will be amortized based on the rates associated with the related assets.

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

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

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) *Inventory and Cost of Sales*.

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

(c) *Property, Equipment and Leaseholds*.

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

Computer hardware	30% Declining balance

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

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

(d) *Impairment of Long Lived Assets*.

The Company assesses the recoverability of its long lived assets by determining whether the carrying value of the long lived assets can be recovered over their remaining lives through undiscounted future operating cash flows using a discount rate reflecting the Company's average cost of funds. The assessment of the recoverability will be impacted if estimated future operating cash flows are not achieved. For the quarters ended September 30, 2006 and 2005, no impairment charges have been recognized.

(e) *Investments.*

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

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

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

(f) *Foreign Currency*.

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

Foreign exchange gains and losses relating to transactions not denominated in the applicable local currency are included in income if realized during the year and in comprehensive income 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 has occurred, the fee is fixed or determinable, collectibility is reasonably assured and there are no significant remaining performance obligations. When significant post-delivery obligations exist, revenue is deferred until such obligations are fulfilled.

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.

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

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

(i) *Stock-based Compensation*.

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

(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*.

Income (loss) per share is calculated by dividing net income (loss) by the weighted average number of shares outstanding. Diluted loss per share is computed by giving effect to all potential dilutive options that were outstanding during the year. For the three quarters ended September 30, 2006 and the years ended December 31, 2005, 2004 and 2003, all outstanding options were anti-dilutive.

(l) *Use of Estimates*.

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

(m) *Financial Instruments*.

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

The Company 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.

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3. Restatements as a Result of Correcting Inventory Levels.

In January 2006, while preparing financials for the year ended December 31, 2005, the Company discovered a material inventory error in the financial statements filed as part of the Company's form 10Q-SB for the quarter ended September 30th 2005. During the inventory count of September 30th 2005 at the factory belonging to our NanoChem Solutions subsidiary, the inventory was overstated by $183,398 due entirely to a clerical error. Reliance on the inventory data led directly to the inaccuracies since identified in the Company's financials contained in its 10Q-SB for the period ended September 30th 2005.

Statement of operations for the nine months ended September 30, 2005 -

	Previously Reported	Increase (Decrease)	Restated
Cost of Goods Sold	$ 2,686,485	$ 183,398	$ 2,869,883
Gross Margin	2,503,318	(183,398)	2,319,920
Net Income (Loss)	(609,627)	(183,398)	(793,025)
Earnings per Share	(0.05)	(0.01)	(0.06)
Deficit, beginning	$ (2,131,407)	-	$ (2,131,407)
Deficit, ending	(2,741,034)	(183,398)	(2,924,432)

Statement of operations for the three months ended September 30, 2005 -

	Previously Reported	Increase (Decrease)	Restated
Cost of Goods Sold	$ 554,540	$ 183,398	$ (737,938)
Gross Margin	747,549	(183,398)	564,151
Net Income (Loss)	(185,508)	(183,398)	(368,906)
Earnings per Share	(0.01)	(0.02)	(0.03)
Deficit, beginning	$ (2,555,526)	$ -	$ (2,555,526)
Deficit, ending	(2,741,034)	(183,398)	(2,924,432)

Balance sheet as at September 30, 2005 -

	Previously Reported	Increase (Decrease)	Restated
Inventory	$ 2,355,729	$ (183,398)	$ 2,172,331
Deficit, beginning	$ (2,131,407)	-	$ (2,131,407)
Deficit, ending	(2,741,034)	(183,398)	(2,924,432)

4. Loan Receivable.

	2006	2005
5% loan receivable due on demand	$ 36,385	$ 35,228

5. Prepaid Expenses.

	2006	2005
Security deposit and prepaids	$ 169,628	$ 137,315

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6. Property, Equipment and Leaseholds.

	Cost	Accumulated Amortization	2006 Net	2005 Net
Buildings	$ 3,144,259	$ 657,543	$ 2,486,716	$ 2,688,341
Computer hardware	58,407	32,587	25,820	29,962
Furniture and fixtures	18,383	8,287	10,096	10,965
Office equipment	30,398	17,221	13,177	15,081
Manufacturing equipment	2,224,122	927,752	1,296,370	1,488,208
Trailer	2,080	1,409	671	831
Leasehold improvements	41,295	25,242	16,053	21,362
Trade show booth	7,792	4,199	3,593	4,447
Land	398,186	-	398,186	398,186
	$ 5,924,922	$ 1,674,240	$ 4,250,682	$ 4,657,383

7. Patents

In fiscal 2005, the Company started the patent process for additional WATER$AVR® products. The amounts recorded represent the fees paid to date. As the patent process is not yet completed, amortization has not yet been recognized. Patents are amortized over their useful lives once granted.

	2006	2005
Patents	$ 154,526	143,822

8. Investment.

	2006	2005
Tatko Inc.	$ 271,000	$ 271,000
Air Water Interface Delivery & Detection Inc.	$ 98,000	98,000
	$ 369,000	$ 369,000

On May 31, 2003, the Company acquired an option to purchase a 20% interest in the outstanding shares of Tatko Inc. (“Tatko”) for consideration of the issuance of 100,000 shares of our common stock. The option to purchase the shares of Tatko expires on May 31, 2008. The cost of the investment has been accounted for based on the original fair market value of our common stock on May 31, 2003. See Contingencies (Note 14).

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

9. Stock Options.

The Company may issue stock options and stock bonuses for our common stock to provide incentives to directors, key employees and other persons who contribute to our success. The exercise price of all incentive options are issued for not less than fair market value.

The following table summarizes stock option activity for the years ended December 31, 2005 and 2004 and for the nine months ended September 30, 2006:

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	Number of shares	Exercise price per share		Weighted average exercise price
Balance, December 31, 2003	1,711,000	$1.00 - $4.25	$	2.84
Granted	572,740	$3.00 - $4.60	$	3.46
Exercised	(37,000)	$1.00 - $2.50	$	1.55
Expired	(5,000)	$4.25	$	4.25
Cancelled	(1,000,000)	$1.50 - $3.50	$	2.50
Balance, December 31, 2004	1,241,740	$1.00 - $4.60	$	2.87
Granted	30,000	$3.58 - $4.40	$	4.17
Exercised	(162,000)	$1.40	$	1.40
Expired	(49,000)	$3.00 - $4.25	$	3.52
Balance, December 31, 2005	1,060,740	$1.00 - $4.55	$	3.44
Granted	1,115,000	$3.25 - $3.50	$	3.25
Cancelled	(65,889)	$1.20 - $4.25	$	2.66
Exercised	(17,111)	$1.40	$	1.40
Balance, September 30, 2006	2,092,740	$1.00 - 4.55	$	3.37

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

	2005	2004	2003
Expected life - years	5.0	5.0	5.0
Interest rate	3.65%	3.5%	2.87%
Volatility	52.0%	49.0%	49.0%
Dividend yield	- %	- %	- %

During the nine months ended September 30, 2006, the Company granted 440,000 options to purchase common stock to outsiders and has applied FAS No. 123(R) using the Black-Scholes option-pricing model, which resulted in additional expenses of $104,451 this quarter (recorded as consulting and investor relations expense), for a total of $263,494 recognized year to date. During the period ended March 31, 2006, the Company granted 675,000 options to employees, resulting in an additional $125,955 in wages and administrative expenses in each quarter ended March 31, 2006, June 30, 2006 and September 30, 2006. During the year ended December 31, 2005, the Company granted 30,000 (2004 - 275,400) stock options to consultants and has applied FAS No. 123 using the Black-Scholes option-pricing model, which resulted in additional expenses of $9,350 (2004 - $299,345). During the year ended December 31, 2005, the Company recognized $93,600 in expenses for 90,000 options granted in the year ended December 31, 2004, but which vested in the year ended December 31, 2005. During the year ended December 31, 2005, 250,000 options, which were granted in 2004, vested according to the fulfillment of certain milestones, which resulted in additional expenses of $422,500.

10. Warrants

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

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On June 8, 2005, the Company announced that it had raised an additional $327,750 pursuant to a private placement of up to 174,800 shares of its common stock. An investor purchased 87,400 shares of the Company's common stock at a per share price of $3.75, together with a warrant to purchase up to 87,400 additional shares of the Company's common stock. The warrant has a four-year term and is immediately exercisable at a price of $4.50 per share.

The following table summarizes the Company's warrant option activity for the year ended December 31, 2005 (no prior or subsequent activity):

	Number of shares	Exercise price per share	Weighted average exercise price
Balance, December 31, 2004	—	—	—
Granted	987,400	$4.50	$4.50
Exercised	—	—	—
Cancelled	—	—	—
Balance, December 31, 2005	987,400	$4.50	$4.50

11. Capital Stock.

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

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

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

On June 8, 2005, the Company announced that it had raised an additional $327,750 pursuant to a private placement of up to 174,800 shares of its common stock. An investor purchased 87,400 shares of the Company's common stock at a per share price of $3.75, together with a warrant to purchase up to 87,400 additional shares of the Company's common stock. The warrant has a four-year term and is immediately exercisable at a price of $4.50 per share.

The purpose of these transactions was to provide sufficient working capital for the Company to retire the debt remaining from its acquisition of certain assets from Donlar Corporation in June 2004. Costs associated with these two capital raises, including the registration rights penalty payment of $326,710, were $847,110, making the net proceeds $2,855,640.

During the year ended December 31, 2005 the Company issued 162,000 shares of common stock at $1.40 per share upon exercise of stock options.

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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 storing evaporation from the pool surface, and (ii) food-safe powdered form of the active ingredient within the liquid blanket which is designed to be used in still or slow moving drinking water sources.

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

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

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

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	Nine Months Ended September 30th 2006	2005
Revenue		
EWCP	$ 1,226,550	$ 862,537
BPCA	5,446,241	4,327,266
Consolidated	6,672,791	5,189,803
Interest revenue		
EWCP	2,684	4,088
BPCA	0	57
Consolidated	2,684	4,145
Interest expense		
EWCP	301	6,611
BPCA	1,673	55,578
Consolidated	1,974	62,189
Depreciation and amortization		
EWCP	42,792	42,452
BPCA	405,102	446,277
Consolidated	447,894	488,729
Segment profit (loss) prior to other items		
EWCP	(1,084,519)	(1,417,298)
BPCA	643,719	620,128
Consolidated	(440,800)	(797,170)
Segment assets		
EWCP	374,305	311,577
BPCA	4,030,903	4,580,700
Consolidated	4,405,208	4,892,277
Expenditures for segment assets		
EWCP	12,270	118,245
BPCA	28,923	12,416
Consolidated	41,193	130,661

The EWCP shows a reduction in expenditures for segment assets due to a credit being issued on costs associated with development of new patents.

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The sales generated in the United States of America and Canada is as follows:

	2006	2005
Canada	$ 199,312	$ 154,063
United States and abroad	6,473,479	5,035,740
Total	$ 6,672,791	$ 5,189,803

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

	2006	2005
Canada	$ 369,086	$ 311,576
United States	4,036,122	4,580,701
Total	$ 4,405,208	$ 4,892,277

13. Commitments.

The Company is committed to minimum rental payments for property and premises aggregating approximately $468,757 over the term of four leases, the last expiring on September 30, 2009.

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

2006	$ 69,108
2007	147,948
2008	150,217
2009	101,484

14. Contingencies.

On May 1, 2003, the Company filed a lawsuit in the Supreme Court of British Columbia, Canada, against John Wells and Equity Trust, S.A. seeking the return of 100,000 shares of the Company's common stock and the repayment of a $25,000 loan, which were provided to defendants for investment banking services consisting of securing a $5 million loan and a $25 million stock offering. Such services were not performed and in the proceeding the Company seeks return of such shares after defendant's failure to both return the shares voluntarily and repay the note. On May 7, 2003, the Company obtained an injunction freezing the transfer of the shares. On May 24, 2004, there was a hearing on defendant's motion to set aside the injunction, which motion was denied by the trial court on May 29, 2004. On the date of issuance, the share transaction was recorded as shares issued for services at fair market value, a value of $0.80 per share. No amounts have been recorded as receivable in the Company's consolidated financial statements as the outcome of this claim is not determinable.

On November 13, 2003, Patrick Grant, an ex-employee, filed a lawsuit in the Circuit Court of Cook County, Illinois against the Company, WaterSavr Global Solutions Inc. ("WGS"), the wholly-owned subsidiary of the Company, and Daniel B. O'Brien, the Company's Chief Executive Officer. The plaintiff claims damages for breach of contract, tortious interference with an agreement and various wrongful discharge claims. The plaintiff seeks monetary damages in excess of $1,020,000 for the breach of contract and tortious interference claims and unspecified compensatory and punitive damages in the wrongful discharge claims. The parties completed mandatory mediation ordered by the Circuit Court and will next appear in court for case management, at which time the court will set discovery deadlines.

The Company considers the case without merit and is vigorously disputing the claims. In addition, the Company intends to file counterclaims against the plaintiff for failure to repay financial obligations owed to the Company of almost $40,000, as well as unspecified damages arising out of the plaintiff's disclosure of confidential information to a client during his employment at WGS. No amounts have been recorded as receivable and no accrual has been made for any loss in the Company's consolidated financial statements as the outcome of the claim filed by the plaintiff is not determinable

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On May 28, 2004, Sun Solar Energy Technologies, Inc. ("Sun Solar"), filed a lawsuit in the Federal Court of Canada, against the Company, Flexible Solutions Ltd., and Mr. O'Brien. Sun Solar is seeking: (a) a declaration that the trademark "Tropical Fish" is available for use by Sun Solar; (b) injunctive relief against further use of the "Tropical Fish" trademark by the Company; and (c) monetary damages exceeding $7,000,000 for the alleged infringement by the Company, Flexible Ltd. and Mr. O'Brien of the "Tropical Fish" trademark, as well as any other "confusingly similar trademarks" or proprietary trade dresses. On August 9, 2004, the Company, Flexible Solutions Ltd. and Mr. O'Brien filed their defense and filed a counterclaim against Sun Solar. The counterclaim seeks: (x) injunctive relief against further use of the "Tropical Fish" trademark by Sun Solar; (y) a declaration that the "Tropical Fish" trademark is owned by the Company, or, in the alternative, is not distinctive and should be struck from the trademark registry; and (z) monetary damages exceeding $50,000. The parties have completed documentary discovery and examinations for discovery of all parties. No amounts have been recorded as receivable in the Company's consolidated financial statements and no amounts have been accrued as potential losses as the outcome of this claim is not determinable.

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

In addition, Tatko filed its own suit on September 24, 2004 in the Circuit Court of Cook County, Illinois seeking declaratory relief of its entitlement to the Company's restricted common stock. On May 23, 2005, the Tatko suit was dismissed with prejudice by the Circuit Court. No amounts have been recorded as receivable in the Company's consolidated financial statements and no amount has been accrued as a loss as the outcome of the claim against Tatko is not determinable.

On January 12, 2005, the Company filed a lawsuit in the Court of the Queen's Bench of Alberta, in which our subsidiary, Flexible Solutions Ltd., is inter-provincially registered. The Company was seeking indeterminate damages resulting from a breach of contract by Calgary Diecast Corporation ("CDC"). The contract at issue was never completed and raw materials belonging to the Company remain in the possession of CDC. On April 25, 2005, the court ordered a judgment in favor of the Company in the amount of $47,495 and the intention is to collect on this judgment using all available means.

15. Comparative Figures.

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

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Item 2. Management's Discussion and Analysis or Plan of Operation.

Overview

Flexible Solutions International, Inc. ("we," "us," and "our") develops, manufactures and markets specialty chemicals that slow the evaporation of water. Our initial product, HEAT$AVR®, is marketed for use in swimming pools and spas where its use, by slowing the evaporation of water, allows the water to retain a higher temperature for a longer period of time and thereby reduces the energy required to maintain the desired temperature of the water in the pool. Our newest product, WATER$AVR®, is marketed for water conservation in irrigation canals, aquaculture, and reservoirs where its use slows water loss due to evaporation. We also make and sell dispensers which automate the deployment of our chemical products.

Results of Operations

The following analysis and discussion pertains to our results of operations for the three and nine month periods ended September 30, 2006, as compared to the results of operations for the three and nine month periods ended September 30, 2005, and to changes in our financial condition from December 31, 2005 to September 30, 2006.

Nine Months Ended September 30, 2006, 2005 and 2004

Separate financial data for each of our operating segments is provided below. We evaluate the performance of our operating segments based on the following:

	Nine Months Ended September 30,			% Change	% Change
	2006	2005	2004	2006-2005	2005-2004
Sales					
Energy Segment	$ 1,226,550	$ 862,537	$ 900,789	42%	(4%)
Polymer Segment	$ 5,446,241	4,327,266	1,511,136*	26%	186%*
Consolidated	$ 6,672,791	$5,189,803	$ 2,411,925	29%	115%
Gross Profit					
Energy Segment	$ 632,562	$ 393,344	$ 458,152	61%	(14%)
Polymer Segment	$ 2,242,580	1,926,576	1,124,459*	16%	71%*
Consolidated	$ 2,875,142	$2,319,920	$ 1,582,611	24%	47%
SG&A					
Energy Segment	$ 1,717,081	$1,810,643	$ 1,470,207	(5%)	23%
Polymer Segment	$ 1,598,861	1,306,447	878,107*	22%	49%*
Consolidated	$ 3,315,942	$3,117,090	$ 2,348,314	6%	33%
Net Income (Loss) before other items	$ (440,800)	$ (797,170)	$ (765,703)*	45%	(4%)*
Interest Income					
Energy Segment	$ 2,684	$ 4,088	$ 33,463	(34%)	(88%)
Polymer Segment	$ -	57	-*	-	-*
Consolidated	$ 2,684	$ 4,145	$ 33,463*	(35%)	(88%)*

Registration rights penalty	$ (326,710)	-	-	-	-
Net Income (Loss) after other items	$ (764,826)	$ (793,025)	$ (732,240)*	4%	(8%)*

* Full nine months of Polymer segment data is not available as indicated. Our polymer segment was formed after the acquisition of certain assets of the Donlar Corporation in June 2004.

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For the nine months ended September 30, 2006 we had a net loss before other items of $440,800 as compared to a net loss before other items of $797,170 for the nine months ended September 30, 2005. Due to a contractual agreement from the equity raise in the spring of 2005, we recorded $326,710 as a registration rights penalty in the nine months ended September 30, 2006, increasing our loss. After all other items, our GAAP net loss for the nine months ended September 30, 2006 was $637,747 as compared to a net loss after other items of $793,025 for the nine months ended September 30, 2005. The $326,710 penalty recorded in the quarter ended September 30, 2006 is a one time occurrence that management believes should have been recorded directly against the corresponding capital, which was raised in 2005. However, at the date of issuance of the capital, it was deemed to be very unlikely that any obligation would arise and as such, we were not able to make a reasonable estimate of a potential liability. Given these circumstances, GAAP measures require we record the payment as an other item on our income statement. All contractual obligations related to the equity raised in 2005 are now complete and no more amounts will become due.

Increased brand recognition, increased sales of our residential swimming pool product, ECO$AVR®, and increased sales from our NanoChem division resulted in sales of $6,672,791 in the nine months ended September 30, 2006, as compared to $5,189,803 in the nine months ended September 30, 2005. Our Energy segment had sales of $1,226,550 for nine months ended September 30, 2006, as compared to $862,537 for the nine months ended September 30, 2005, an increase of 42%. Our Polymer segment had sales of $5,446,241 for the nine months ended September 30, 2006, as compared to sales of $4,327,266 for the nine months ended September 30, 2005, an increase of 26%.

Our management is satisfied with the effect of the acquisition of assets from Donlar Corporation (“Donlar”), as the NanoChem division (which is comprised of the former Donlar assets) has contributed greatly to sales and cash flow and is starting to replace the capital expended to acquire the assets. In addition, opportunities to synergistically cross-sell all of our divisions’ products have already generated leads to new business and the swimming pool division has discovered ways to help NanoChem increase utilization of its Peru, Illinois factory, while decreasing our costs as a whole. We maintained expenditures in the areas of WATER$AVR® product sales and marketing costs and production equipment development costs. The major factors that contributed to our increased revenue were greater sales from our HEAT$AVR® and ECO$AVR® swimming pool division and an increase in sales from our newly-formed NanoChem division. NanoChem sales are much less seasonal than those of our WATER$AVR® product and HEAT$AVR® and ECO$AVR® products divisions. As NanoChem sales increase, we anticipate that we will experience a reduction in the volatility of our sales over time.

Gross profit margin represents sales less cost of sales and producing. The major categories of costs included in cost of sales and producing are cost of goods, distribution costs, and costs of our buying department. Distribution costs consist of all warehouse receiving and inspection costs, warehousing costs, all transportation costs associated with shipping goods from our facilities to our customers, and other costs of distribution. We do not exclude any portion of distribution costs from cost of sales. Our gross margins may not be comparable to those of other entities because some entities include all of the costs related to their overhead in cost of sales. However, we exclude a portion of cost of sales from gross profit and instead include such costs as a line item in operating expenses.

Our operating expenses were $3,315,942 for the nine months ended September 30, 2006 as compared to $3,117,090 for the nine months ended September 30, 2005. As sales increased 29%, a modest increase in operating expenses of 6% is reasonable. Our largest increases were in research and development ($102,059 for the nine months ended September 30, 2006, as compared to $39,247 for the nine months ended September 30, 2005) and insurance ($161,050 for the nine months ended September 30, 2006 as compared to $104,874 for the nine months ended September 30, 2005). The insurance increase was unavoidable and is comparable to what others are experiencing in the industry. Our increase in research is a result of more money being spent to better compete in the market with new or improved products. Consulting expenses increased ($290,859 for the nine months ended September 30, 2006, as

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compared to $117,855 for the nine months ended September 30, 2005) as a direct result of recognizing $188,890 for the nine months ended September 30, 2006 (2005 - $54,600) for stock options granted to consultants. The increase in wages and administrative salaries are in part due to the application of SFAS 123 (R) that now requires companies to apply a fair value based measurement method to employee stock options. After applying SFAS 123(R) to employee granted stock options, the company recognized an additional $277,864 in expenses for the nine months ended September 30, 2006. Our decreases in advertising ($35,834 for the nine months ended September 30, 2006, as compared to $61,931 for the nine months ended September 30, 2005), travel ($78,217 for the nine months ended September 30, 2006 as compared to $105,185 for the nine months ended September 30, 2005) and telecommunications ($24,442 for the nine months ended September 30, 2006 as compared to $31,987 for the nine months ended September 30, 2005) are the result of better cost-control in these areas instituted by management over the past year. The decrease in interest expense ($1,974 for the nine months ended September 30, 2006, as compared to $62,189 in the nine months ended September 30, 2005) is a direct result of the Company paying off the short-term loan used for the purchase of assets to create the NanoChem division. The decrease in investor relations ($146,009 in the nine months ended September 30, 2006 as compared to $551,486 for the nine months ended September 30, 2005) is a direct result of large stock option expense in relation to our 2005 equity raise. During the nine months ended September 30, 2006, the company recognized $74,604 (2005 - $463,100) for stock options granted in relation to investor relations.

Our Energy segment generated $1,717,081 in operating expenses in the nine months ended September 30, 2006, a decrease from $1,810,643 from the nine months ended September 30, 2005. This five percent decrease is partially attributable to the stock options that vested in our quarter ended June 30, 2005 but is not wholly transparent due to the application of SFAS 123(R) which started in January 2006. Our Polymer segment generated $1,598,861 in operating expenses in the nine months ended September 30, 2006, an increase from $1,306,447 for the nine months ended September 30, 2005. This twenty two percent increase is attributable to the twenty six percent increase in sales as well as the application of SFAS 123(R).

Our net loss before other items for the nine months ended September 30, 2006 was $440,800, a decrease from our net loss of $797,170 in the nine months ended September 30, 2005. The decrease in net loss is attributable to increased sales in all divisions, as compared to the nine months ended September 30, 2005, augmented by positive operating cash from our NanoChem division. Our Energy segment's net loss before other items for the nine months ended September 30, 2006 was $1,084,519, a decrease from our net loss of $1,417,298 in the nine months ended September 30, 2005, which is attributable to our increased brand recognition and sales. Our Polymer segment's net profit for the nine months ended September 30, 2006 was $643,719, a modest increase over the net profit of $620,128 for the nine months ended September 30, 2005. This increase is not as high as could be expected for the 22 % increase of sales and is attributable to higher cost of goods sold, a result of the rise in oil prices worldwide, as well as the application of SFAS 123 (R).

Our net loss after other items and income tax is $637,747 for the nine months ended September 30, 2006 as compared to a net loss of $793,025 for the nine months ended September 30, 2005. The $326,710 penalty recorded in the quarter ended September 30, 2006 is a one time occurrence that management believes should have been recorded directly against the corresponding capital, which was raised in 2005. However, at the date of issuance of the capital, it was deemed to be very unlikely that any obligation would arise and as such, we were not able to make a reasonable estimate of a potential liability. Given these circumstances, GAAP measures require we record the payment as an other item on our income statement. All contractual obligations related to the equity raised in 2005 are now complete and no more amounts will become due.

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Our loss per share was $0.05 for the nine months ended September 30, 2006, as compared to a loss of $0.06 per share for the nine months ended September 30, 2005. Our loss per share prior to the registration rights penalty would have been $0.02.

Three Months Ended September 30, 2006 and 2005

For the three months ended September 30, 2006, we experienced a net loss before other items of $176,571, as compared to a net loss before other items of $369,434 for the three months ended September 30, 2005. Due to a contractual agreement from the equity raise in the spring of 2005, we recorded $326,710 as a registration rights penalty in the three months ended September 30, 2006, increasing our loss. After all other items, our GAAP net loss for the three months ended September 30, 2006 was $502,449 as compared to a loss of $368,309 for the three months ended September 30, 2005. The $326,710 penalty recorded in the quarter ended September 30, 2006 is a one time occurrence that management believes should have been recorded directly against the corresponding capital, which was raised in 2005. However, at the date of issuance of the capital, it was deemed to be very unlikely that any obligation would arise and as such, we were not able to make a reasonable estimate of a potential liability. Given these circumstances, GAAP measures require we record the payment as an other item on our income statement. All contractual obligations related to the equity raised in 2005 are now complete and no more amounts will become due.

Increased brand recognition, increased sales of our residential swimming pool product, ECO$AVR®, and increased sales from our NanoChem division resulted in sales of $1,913,958 in the three months ended September 30, 2006, as compared to $1,302,089 in the three months ended September 30, 2005. Our Energy segment had sales of $229,431 for the three months ended September 30, 2006, as compared to $96,916 for the three months ended September 30, 2005, an increase of 137%. Our Polymer segment had sales of $1,684,527 for the three months ended September 30, 2006, as compared to sales of $1,205,173 for the three months ended September 30, 2005, an increase of 40%.

Gross profit margin represents sales less cost of sales and producing. The major categories of costs included in cost of sales and producing are cost of goods, distribution costs, and costs of our buying department. Distribution costs consist of all warehouse receiving and inspection costs, warehousing costs, all transportation costs associated with shipping goods from our facilities to our customers, and other costs of distribution. We do not exclude any portion of distribution costs from cost of sales. Our gross margins may not be comparable to those of other entities because some entities include all of the costs related to their overhead in cost of sales. However, we exclude a portion of cost of sales from gross profit and instead include such costs as a line item in operating expenses.

Our operating expenses were $1,063,255 for the three months ended September 30, 2006, a modest increase of $129,670 over the three months ended September 30, 2005 considering the 47 % increase in sales. We continued our sales and marketing efforts for our WATER$AVR® product line, with the objective of closing major sales as soon as possible. The largest increases in operating expenses were in the areas of wages ($253,253 for the three months ended September 30, 2006, as compared to $202,776 in the three months ended September 30, 2005), administrative salaries ($155,841 for the three months ended September 30, 2006, as compared to $56,760 in the three months ended September 30, 2005), and investor relations ($82,676 for the three months ended September 30, 2006 as compared to $41,897 for the three months ended September 30, 2005). The increase in wages and administrative salaries are in part due to the application of SFAS 123 (R) that now requires companies to apply a fair value based measurement method to employee stock options. After applying SFAS 123(R) to employee granted stock options, the company recognized an additional $125,955 in expenses this quarter. These increases are also partially accounted for by the increase in sales and represent a permanent increase in operating costs related to the new level of sales. The increase in consulting ($94,811 for the three months ended September 30, 2006 as compared to $26,069 for the three months ended September 30, 2005) are a direct result of stock option expenses. The Company recognized $61,152 in stock option expenses related

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to consulting in the three months ended September 30, 2006 (2005 - $18,200). Our decreases in advertising ($3,450 for the three months ended September 30, 2006, as compared to $17,246 in the three months ended September 30, 2005) and office and miscellaneous ($29,815 for the three months ended September 30, 2006 as compared to $57,456 for the three months ended September 30, 2005) are the result of better cost-control in these areas instituted by management over the past year.

Our Energy segment generated $584,287 in operating expenses in the three months ended September 30, 2006, an increase from $516,723 for the three months ended September 30, 2005. This 13% increase is attributable to our increase of sales as well as the application of SFAS 123(R). Our Polymer segment generated $478,967 in operating expenses in the three months ended September 30, 2006, an increase of $62,103. This 15% increase is wholly attributable to the 40% percent increase in sales as well as the application of SFAS 123(R).

Our net loss before other items for the three months ended September 30, 2006 was $176,571, a decrease from our net loss before other items of $369,434 in the three months ended September 30, 2005. The decrease in net loss before other items is attributable to increased sales in all divisions, as compared to the three months ended September 30, 2005, augmented by positive operating cash from our NanoChem division. Our Energy segment's net loss before other items for the three months ended September 30, 2006 was $494,698, an increase from our net loss of $433,933 in the three months ended September 30, 2005, which is attributable to the application of SFAS 123(R). Our Polymer segment's net profit before other items for the three months ended September 30, 2006 was $318,127, an increase over the net profit before other items of $64,499 for the three months ended September 30, 2005. This 393% increase in profits is attributable to the 40% increase in sales, allowing the division to better obtain economies of scale.

Our net loss after other items is $502,449 for the three months ended September 30, 2006 as compared to a net loss after other items of $368,309 for the three months ended September 30, 2005. The $326,710 penalty recorded in the quarter ended September 30, 2006 is a one time occurrence that management believes should have been recorded directly against the corresponding capital, which was raised in 2005. However, at the date of issuance of the capital, it was deemed to be very unlikely that any obligation would arise and as such, we were not able to make a reasonable estimate of a potential liability. Given these circumstances, GAAP measures require we record the payment as an other item on our income statement. All contractual obligations related to the equity raised in 2005 are now complete and no more amounts will become due.

Our loss per share was $0.04 for the three months ended September 30, 2006, as compared to a loss of $0.03 per share for the three months ended September 30, 2005. Our loss per share prior to the registration rights penalty would have been $0.01.

Liquidity and Capital Resources

The following section discusses the effects of changes in our balance sheet and cash flow on our liquidity and capital resources. The following table summarizes our cash, cash equivalents and working capital that directly have an impact on our immediate and future cash needs and sources.

	September 30, 2006	December 31, 2005	Increase (Decrease)
Cash and cash equivalents	$418,425	$526,292	$(107,867)
Working capital	3,542,998	3,110,090	432,908

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We have cash on hand of $418,425 as of September 30, 2006, as compared to cash on hand of $526,292 at December 31, 2005. The overall decrease in cash and cash equivalents is a result of the increase in working capital.

As of September 30, 2006, we had working capital of $3,542,998, as compared to working capital of $3,101,090 on December 31, 2005. The increase in working capital is the result of sales revenue exceeding cash costs of producing the revenue.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including the fluctuations in our operating results, shipments, accounts receivable collections, and inventory management. As our sales continue to build, our accounts receivable will increase and our overall inventory levels will also increase.

Because we repaid the short-term loan due in June 2005 (incurred in connection with our purchase of the Donlar assets, used to create the NanoChem division), we have no other commitments or guarantees in the next 12 months that will materially affect our cash position or needs. We believe we have sufficient capital to support our business and operations for at least the next 12 months. We anticipate utilizing approximately $500,000 in the next twelve months attempting to close sales in California, Spain and Australia and to extend certain core U.S. patents to select other countries. Approximately 80% of these expenditures will be related to expanding sales for our WATER$AVR® product.

There can be no assurance that any of the expenditures will result in additional sales. In the event that our capital resources are not sufficient for the continued expansion of the Company, new capital will be needed or marketing expenses will have to be curtailed until capital is available. There is no guarantee that capital will be available on terms acceptable to the Company or at all. We have no investment banking agreements in place at this time.

Subsequent Events

There were no subsequent events.

Restatement of Financial Statements

In January 2006, while preparing financials for the year ended December 31, 2005, the Company discovered a material inventory error in the financial statements filed as part of the Company's form 10Q-SB for the quarter ended September 30th 2005. During the inventory count of September 30th 2005 at the factory belonging to our NanoChem Solutions subsidiary, the inventory was overstated by $183,398 due entirely to a clerical error. Reliance on the inventory data led directly to the inaccuracies since identified in the Company's financials contained in its 10Q-SB for the period ended September 30th 2005.

In light of the above, the net effect of the adjustments to the financials statements is as follows:

1. $183,398 decrease in Inventory at September 30, 2005.
2. $183,398 increase in Cost of Goods Sold for the three months ended September 30, 2005.

We are presently unaware of any evidence that the restatements described above are due to any material noncompliance by us, as a result of misconduct, with any financial reporting requirement under the federal securities laws. Our audit committee of the board of directors is working with our management and our accountants to assure that we are taking the appropriate approach to resolving the

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issues related to the restatements, as well as any further issues that may be identified during the course of review.

Item 3. Controls and Procedures.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports to the Securities and Exchange Commission ("SEC") is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide a reasonable level of assurance of reaching our desired disclosure control objectives.

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

The prior accounting treatment of our stock-based compensation expense was done in consultation and in accordance with the advice of our independent accountants. Accordingly, management does not believe that this restatement of our Quarterly Report indicates or results from a material weakness with respect to our disclosure controls and procedures or our internal controls over financial reporting.

Changes in Internal Control Over Financial Reporting

During the first quarter of 2006, upon recommendation of our audit committee, we implemented a new internal control protocol related to inventory counts.

As part of our internal control protocols our senior management selects for review in the next reporting period various numerical data from the previous period. During the compilation of data to be used in the financial statements contained in the our Annual Report for the year ended December 31, 2005, senior management discovered that the number assigned to inventory for the quarter ended September 30, 2005 appeared to be suspect and immediately investigated the issue. Within fifteen days of senior management's review, a mis-transcription in the inventory number was identified and corrected.

Our investigation revealed that, due to a clerical error in transferring the inventory floor count to computerized spreadsheets, certain inventory data was misreported. After correction and disclosure, management referred this matter to the audit committee of our board of directors for review, and determination as to whether a change to our inventory control protocol was necessary or advisable. On January 25, 2006, the audit committee of the board of directors recommended a change to our internal controls related to inventory counts, which now requires that quarterly and annual inventory counts be conducted by plant managers, accompanied by either an equal or more senior level executive from a division reporting directly to our head office, or by an independent accountant reporting in the same manner. This change was implemented and made effective during the first quarter of 2006.

Although we modified our internal control procedures related to inventory matters in the first quarter of 2006, management, our board of directors, including its audit committee, and our independent

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auditor each concluded that no change in the assessment of the effectiveness of our internal controls was necessary based on an isolated event of human error. We believe that such errors are uncommon and that it is not possible to design a system of internal controls that absolutely prevents against human error. Nonetheless, we have implemented the protocol changes described above in an effort to further bolster the accuracy of our inventory data compilation.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

On November 13, 2003, Patrick Grant, an ex-employee, filed a lawsuit in the Circuit Court of Cook County, Illinois against us, WaterSavr Global Solutions Inc. (“WGS”), our wholly-owned subsidiary, and Daniel B. O’Brien, our Chief Executive Officer. The plaintiff claims damages for breach of contract, tortious interference with an agreement and various wrongful discharge claims. The plaintiff seeks monetary damages in excess of $1,020,000 for the breach of contract and tortious interference claims and unspecified compensatory and punitive damages in the wrongful discharge claims. The parties completed mandatory mediation ordered by the Circuit Court and will next appear in court for case management, at which time the court will set discovery deadlines. We consider the case to be without merit, deny the plaintiffs claims and intend to file counterclaims against the plaintiff for failure to repay financial obligations owed to us of almost $40,000, as well as unspecified damages arising out of the plaintiff’s disclosure of confidential information to a client during his employment at WGS. No amounts have been recorded as receivable and no accrual has been made for any loss in our consolidated financial statements as the outcome of the claim filed by the plaintiff is not determinable.

On May 1, 2003, we filed a lawsuit in the Supreme Court of British Columbia, Canada, against John Wells and Equity Trust, S.A., seeking the return of 100,000 shares of our common stock and the repayment of a $25,000 loan, which were provided to defendants for investment banking services consisting of securing a $5 million loan and a $25 million stock offering. Such services were not performed and in the proceeding we seek the return of such shares after defendants’ failure to both return the shares voluntarily and repay the note. On May 7, 2003, we obtained an injunction freezing the transfer of the shares. On May 24, 2004, there was a hearing on defendants’ motion to set aside the injunction, which motion was denied by the trial court on May 29, 2004. On the date of issuance, the share transaction was recorded as shares issued for services at fair market value, a value of $0.80 per share. No amounts have been recorded as receivable in our consolidated financial statements as the outcome of this claim is not determinable.

On May 28, 2004, Sun Solar Energy Technologies, Inc. (“Sun Solar”), filed a lawsuit in the Federal Court of Canada, against us, Flexible Ltd., and Mr. O’Brien. Sun Solar is seeking: (a) a declaration that the trademark “Tropical Fish” is available for use by Sun Solar; (b) injunctive relief against further use of the “Tropical Fish” trademark by us; and (c) monetary damages exceeding $7,000,000 for the alleged infringement by us, Flexible Ltd. and Mr. O’Brien of the “Tropical Fish” trademark, as well as any other “confusingly similar trademarks” or proprietary trade dresses. On August 9, 2004, we filed our defenses and filed a counterclaim against Sun Solar. The counterclaim seeks: (x) injunctive relief against further use of the “Tropical Fish” trademark by Sun Solar; (y) a declaration that the “Tropical Fish” trademark is owned by us, or, in the alternative, is not distinctive and should be struck from the trademark registry; and (z) monetary damages exceeding $50,000. The parties have completed documentary discovery and examinations for discovery of all parties. No amounts have been recorded as receivable in the Company’s consolidated financial statements and no amounts have been accrued as potential losses as the outcome of this claim is not determinable.

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

In addition, Tatko filed its own suit on September 24, 2004 in the Circuit Court of Cook County, Illinois seeking declaratory relief of its entitlement to our restricted common stock. On May 23, 2005, the Tatko suit was dismissed with prejudice by the Circuit Court. No amounts have been recorded as receivable in our consolidated financial statements and no amount has been accrued as a loss as the outcome of the claim against Tatko is not determinable.

On January 12, 2005, we filed a lawsuit in the Court of the Queen's Bench of Alberta, seeking indeterminate damages resulting from a breach of contract by Calgary Diecast Corporation ("CDC"). The contract at issue was never completed and our raw materials remain in the possession of CDC. On April 25, 2005, the court ordered a judgment in our favor in the amount of $47,495.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

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Item 6. Exhibits.

Number	Description
3.1	Amended and Restated Certificate of Incorporation of the registrant. (1)
3.2	Bylaws of the registrant. (1)
31.1	Certification of Principal Executive Officer Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Principal Financial Officer Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. §1350 and §906 of the Sarbanes-Oxley Act of 2002.*
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. §1350 and §906 of the Sarbanes-Oxley Act of 2002.*

* 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.

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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.

Dated: November 14, 2006.

Flexible Solutions International, Inc.

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