FLEXIBLE SOLUTIONS INTERNATIONAL INC
Form 10KSB/A
December 06, 2005

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

FORM 10-KSB/A
(AMENDMENT NO. 1)

(Mark one)

|X| Annual Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004.

|_| 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 in Its Charter)

NEVADA	91-1922863
(State of Incorporation)	(IRS Employer Identification No.)
615 DISCOVERY STREET VICTORIA, BRITISH COLUMBIA, CANADA	V8T 5G4
(Address of Principal Executive Offices)	(Zip Code)

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

NONE
(Securities registered pursuant to Section 12(b) of the Exchange Act)

COMMON STOCK, $0.001 PAR VALUE
(Securities registered pursuant to Section 12(g) of the Exchange Act)

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 |X| No |_|

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. |X|

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

State issuer's revenues for its most recent fiscal year: $3,392,937.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked prices of such common equity, as of a specified date within the past 60 days: As of March 19, 2004, the aggregate market value of the Company's common stock held by non-affiliates was approximately $48,155,898 based on the closing price for shares of the registrant's common stock on the American Stock Exchange for that date.

State the number of shares outstanding of each of the issuer's class of common equity, as of the latest practicable date: As of March 11, 2005, there were 11,831,916 shares of the Company's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

No documents are incorporated by reference.

Transitional Small Business Disclosure Format (check one): Yes |_| No |X|

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
INDEX TO ANNUAL REPORT ON FORM 10-KSB/A
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004

EXPLANATORY NOTE

Flexible Solutions International, Inc. ("we," "us," and "our") is filing this Annual Report on Form 10-KSB/A to amend and restate in its entirety its Annual Report on Form 10-KSB for the fiscal year ended December 31, 2004, which was previously filed with the Securities and Exchange Commission on March 24, 2005.

In October 2005, while completing a registration statement for securities issued in the second quarter of 2005, we determined that certain disclosures made in connection with our stock-based compensation expense required adjustment. As such, on October 5, 2005, upon the recommendation of our management, our board of directors and its audit committee, and our independent accountants, we determined to restate our consolidated financial statements for each of the periods ended since September 30, 2002, including each of the years ended December 31, 2002 through 2004, and for both of the quarters in the six months ended June 30, 2005 (the "Restated Periods").

In accordance with this determination to restate the Restated Periods, we revised the disclosures for stock-based compensation expense as required under Emerging Issues Task Force ("EITF") No. 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services; EITF No. 00-18, Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees; and EITF No. 01-9, Accounting for Consideration Given by a Vendor to a Customer. In particular, we adjusted the stock-based compensation expense in our financial statements and notes thereto recorded in connection with our grant of an option to purchase 2,000,000 shares of our common stock in September 2002 pursuant to the terms of a product distribution agreement. Additional information on this restatement and its effects on our financial condition and results of operations can be found in our Notes to Consolidated Financial Statements contained herein.

This Form 10-KSB/A does not reflect events occurring after the filing of our Form 10-KSB on March 24, 2005 or modify any of the disclosures contained therein, or in the accompanying financial statements and notes thereto, in any way other than by the amendments identified above and as set forth herein. Notwithstanding the above, and for the convenience of the reader, this entire report has been amended as a result of, and to reflect, the restatement, as well as to revise the disclosure of our description of business, legal proceedings, management's discussion and analysis, as well as our risk factors, unregistered sales of equity securities, directors and executive officers, and principal accountant fees and services, as well as to generally reflect the current disclosure requirements of Form 10-KSB.

This Form 10-KSB/A should be read in conjunction with our periodic filings made with the Securities and Exchange Commission subsequent to the date of their original filings, including any amendments to those filings. In addition, in accordance with Rule 12b-15 under the Securities Exchange Act of 1934, as amended, and certain other rules, this Form 10-KSB/A includes an updated Auditor's Report and Consent of Independent Registered Public Accounting Firm and updated certifications from our Chief Executive Officer and Chief Financial Officer.

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 issues related to the restatements, as well as any further issues that may be identified during the course of its review. The filing of this Form 10-KSB/A shall not be deemed an admission that the original filing, when made, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement not misleading.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-KSB/A for the year ended December 31, 2004 ("Annual Report"), including the Notes to Unaudited 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, our ability to increase distribution of our products, integration of businesses we acquire, and disposition of any of our current business. 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 the actual results will be consistent with these forward-looking statements. Except as otherwise required by Federal 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.

OUR COMPANY

Flexible Solutions International, Inc.

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

We were incorporated as Flexible Solutions, Ltd. (referred to hereinafter as "Flexible Ltd."), a British Columbia corporation, on January 26, 1991. On May 12, 1998, we merged Flexible Ltd. with and into Flexible Solutions International, Inc., a Nevada corporation, and, in exchange for all of the outstanding shares of Flexible Ltd., we issued 7,000,000 shares of common stock, which represented all of our then-issued and then-outstanding shares, to the former shareholders of Flexible Ltd. Flexible Ltd. is now our wholly-owned subsidiary. For further information on Flexible Ltd., see "Our Subsidiaries--Flexible Solutions, Ltd." below. At the time of our merger with Flexible Ltd., we had no other business and were incorporated solely in order to acquire Flexible Ltd. This merger facilitated the establishment of a public trading market for our common stock. Trading in our common stock commenced on October 12, 1999, through the OTC Bulletin Board under the trading symbol "FXSO". Since November 2002, our common stock has traded on the American Stock Exchange under the trading symbol "FSI".

OUR SUBSIDIARIES

We are the parent holding company for Flexible Ltd., WaterSavr Global Solutions Inc. (hereinafter referred to as "WaterSavr") and NanoChem Solutions Inc. (hereinafter referred to as "NanoChem").

Flexible Solutions, Ltd.

Flexible Ltd., a British Columbia corporation, was organized to develop and market swimming pool chemical products designed to reduce heat loss. HEAT$AVR(R) and ECO$AVR(TM) are Flexible Ltd.'s principal products. For further information on these products, see "Our Products--HEAT$AVR(R) and ECO$AVR(TM)" below.

WaterSavr Global Solutions Inc.

In 2002, we established WaterSavr Global Solutions, Inc. to concentrate on the marketing of our WATER$AVR(R) product. Since February 7, 2005, WaterSavr has been a Nevada corporation. WATER$AVR(R) is a patented powder that, when deployed onto a water surface of any size, will significantly reduce evaporation. For further information on our WATER$AVR(R) products, see "Our Products--WATER$AVR(R)" below.

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NanoChem Solutions Inc.

On May 25, 2004, we formed NanoChem in order to acquire certain of the assets of Donlar Corporation, which owned a broad portfolio of environmentally friendly technologies and products. In June 2004, NanoChem purchased these assets from Donlar Corporation's bankruptcy estate for $6.15 million. In exchange for the capital contribution necessary to purchase the Donlar assets, we were issued all of the outstanding shares of NanoChem, making it our wholly-owned subsidiary. The newly acquired assets include 52 U.S. and 139 International patents relating to environmental products and technologies, as well as a 56,780 sq. ft. manufacturing plant on 40 acres of property in an area outside of Chicago, Illinois. As part of the asset acquisition from Donlar International, we also acquired leaseholds to corporate offices and a laboratory in Bedford Park, Illinois that are now occupied by NanoChem. The principal products that we acquired from Donlar International via our wholly-owned subsidiary, NanoChem, consist of water-soluble chemicals utilizing thermal polyaspartate biopolymers (hereinafter referred to as "TPAs"), which are beta-proteins manufactured from the common biological amino acid, L-aspartic. TPAs can be formulated to prevent corrosion and scaling in water piping within the petroleum, chemical, utility and mining industries. TPAs are also used as proteins to enhance fertilizers in improving crop yields and as additives for household laundry detergents, consumer care products, and pesticides. For further information on these products, see "Our Products--Biopolymer Products (TPAs)" below.

OUR PRODUCTS

HEAT$AVR(R) and ECO$AVR(TM)

Our principal products consist of the HEAT$AVR(R) and ECO$AVR(TM) branded chemical solutions. HEAT$AVR(R) is a chemical product for use in swimming pools and personal spas that forms a thin, transparent layer on the water's surface that reduces water evaporation and heat loss. We market the HEAT$AVR(R) product as a cost-effective and convenient way to save on the cost of energy required to heat pools and spas. Our studies indicate that approximately 70% of the energy lost from a swimming pool occurs through water evaporation. By using our HEAT$AVR(R) product, we can minimize that heat loss and save our customers money on their pool and spa energy needs. For example, we have received reports from our commercial customers documenting energy savings of between $2,400 to $6,000 per year when using our HEAT$AVR(R) product.

We completed the development of our HEAT$AVR(R) product and introduced it to the commercial marketplace in 1998, achieving initial sales of $84,252 that year. Since that time, we have expanded our marketing of the HEAT$AVR(R) product to include the residential marketplace. We found that by designing the HEAT$AVR(R) product to be "residential-friendly," we could increase sales. As a result, we created a patented, fish-shaped dispensing unit for the HEAT$AVR(R) residential market and have designated the dispensing unit as the ECO$AVR(TM). Since that time, we have increased sales and market share on our HEAT$AVR(R) and ECO$AVR(TM) products.

Each ECO$AVR(TM) dispenser is made of molded plastic in the form of a ten-inch long colorful ECO$AVR(TM) fish that is filled with enough HEAT$AVR(R) solution to cover the surface of a 400 sq. ft. swimming pool for about one month. The ECO$AVR(TM) is deployed by cutting off the dorsal fin and tossing the fish into the pool where it submerges to the bottom. Differential pressure causes the HEAT$AVR(R) solution inside the ECO$AVR(TM) to escape into the water where it rises to the surface and forms a transparent layer on the water's surface. Once the ECO$AVR(TM) is empty, the dispenser is removed and replaced. We also make and sell automatic metering system dispensers for automatically dispensing HEAT$AVR(R) into a swimming pool or spa. The dispenser contains a reservoir holding a one gallon supply of HEAT$AVR(R). The unit is programmed to inject the appropriate amount of the HEAT$AVR(R) product into the pool at the rate of one ounce per 400 sq. ft. of pool surface per day.

The ECO$AVR(TM) product has a suggested retail price of between $11.95 and $14.95 in the United States. HEAT$AVR(R) retails for between $200 and $300 per four gallon case in the United States. In outdoor swimming pools, our HEAT$AVR(R) product can provide savings on pool heating costs and provides convenience of use when 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. They float on the surface and perform the same function as our HEAT$AVR(R) product: reducing energy cost by inhibiting water evaporation. Pool personnel often find it inconvenient to use conventional pool blankets because a pool blanket must be removed and stored prior to entering the pool and provides no energy savings when not on the pool. Conversely, our HEAT$AVR(R) product eliminates the necessity of installing, removing and storing the blanket and works 24 hours a day. We believe that the ease of use provided by HEAT$AVR(R) results in more consistent pool and spa usage. In addition, the use of HEAT$AVR(R) in an indoor pool results in even greater energy savings. 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 because less is heat transferred from the pool water to the surrounding air and less water vapor will have to be removed from the air to maintain the required comfort level.

We market our HEAT$AVR(R) and ECO$AVR(TM) products to both residential and commercial markets, consisting of individual homeowners with swimming pools and personal spas and commercial consumers consisting of operators of swimming pools and personal spas located in hotels, motels, schools, and municipal and private recreational facilities.

Traditionally, we sold our HEAT$AVR(R) and ECO$AVR(TM) products directly to a wholesale network. However, in February 2004, we reorganized the distribution of our HEAT$AVR(R) and ECO$AVR(TM) products so that we now handle distribution of the products from our new sales and marketing office in Richmond, British Columbia. By bringing our product distribution in-house, we believe we can fully integrate our manufacturing and distribution processes such that we can increase our revenue per unit by 100%. While we now maintain greater control over our distribution process, we also still maintain non-exclusive distributorships in Canada and the United States for the sale of bulk HEAT$AVR(R) (without the ECO$AVR(TM) dispenser) and exclusive distributorships in Australia, Japan, Korea, Spain and Great Britain. 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, maintain a semi-annual newsletter that is sent to buyer associations, customers and potential customers, and maintain an internet presence containing information about our products.

WATER$AVR(R)

We introduced our WATER$AVR(R) product in June 2002. This product utilizes our core technology to reduce water evaporation. We market it as a water conservation product for use where water is standing or gently flowing and the need for water conservation can justify the cost of purchase and deployment of the product. We believe that our WATER$AVR(R) product may find a market for use in the following markets: reservoirs, potable water storage, aqueducts and canals, agricultural irrigation, flood water crops, lawn and turf care, potted and bedding plants, stock watering ponds, and mining.

WATER$AVR(R) is sold in granulated form and can be provided in shaker containers holding 3/4 lbs. or in 50 lbs. weatherproof bags. WATER$AVR(R) can be applied in various ways from hand dispersal to fully automated scheduled metering, and we also offer an automatic dispenser for WATER$AVR(R) to automate deployment of the product.

In May 2004, the Metropolitan Water District of Southern California awarded us a $30,000 grant under that agency's Innovation Supply Program for an evaporation control project to start in June 2004. In September and October 2004, we achieved positive results from our evaporation control testing conducted at Owens Lake, California. The evaporation control results were as follows:

- Evaporation reduction for 2- and 3-day application cycles over September and October were 37% and 30%, respectively; and

- Evaporation savings were as high as 54% and as low as 22% on individual days depending on environmental factors.

We also ordered a simultaneous toxicity study to be performed by McGuire Environmental Consultants Inc. of Denver, Colorado to determine if any water quality change occurred as a result of the application of WATER$AVR(R) to a body of water. With respect to the environmental impact testing performed in Colorado, the results were as follows:

- No effect on odor;

- No effect on invertebrates;

- No effect on vertebrates;

- No anticipated effect on any current drinking water treatment processes; and

- Biodegradability reconfirmed independently.

We anticipate our initial market for WATER$AVR(R) will be in Spain, Australia and the United States. We have provided quantities of the product for testing in these countries and, if successful, we anticipate that substantial orders may be received. We also anticipate marketing WATER$AVR(R) to both developed and drought stricken countries to address water conservation concerns. In this regard, we are seeking to establish strategic relationships with companies in the water processing industry who have marketing and manufacturing operations in countries with water conservation concerns. We have two full time employees and two other employees more than 50% assigned to establishing sales channels throughout the world for WATER$AVR(R).

WATER$AVR--BTI(TM)

Over the last three years, our continued research and development has resulted in a patent pending modification of the original WATER$AVR(R) that combines evaporation control with control of mosquito larvae before they reach adult stage. The result is our new WATER$AVR--BTI(TM) product. The BTI portion of the product is a recognized and approved, environmentally friendly method of killing mosquito larvae during the first, second, and third stages of larvae development. Combined with our original WATER$AVR(R) product, WATER$AVR--BTI(TM) can be effectively and quickly spread across large and small water surfaces evenly and can be constrained to the water/air interface where larvae must go to obtain air.

In November 2004, after announcing positive test results from independent trials conducted at Louisiana State University on the efficacy of the WATER$AVR--BTI(TM) product, we filed an application with the U.S. Environmental Protection Agency to obtain product registration. This application is still pending.

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Included in our application were the results of the field tests on the performance of WATER$AVR--BTI(TM), carried out by the Entomology Department at the Louisiana State University Agricultural Center in Crowley, Louisiana. The application underscored the results of the field testing: WATER$AVR--BTI(TM) has been shown to correspond to a reduction in the density of mosquito larvae present in a body of water. These field tests back up our internal laboratory tests, showing that the use of WATER$AVR--BTI(TM) resulted in a 100% kill rate of mosquito larvae in contact with the product.

Biopolymer Products (TPAs)

Our subsidiary, NanoChem, produces water soluble, biodegradable polymers, or TPAs, used in industrial and consumer products. TPAs have a wide range of molecular weights. The ideal weight depends on the application, formulation and required performance characteristics in specific processes. This allows for customization of the products to correspond to particular product applications.

TPAs FOR OILFIELDS. TPAs are used to reduce scale and corrosion in various "topside" water systems. They are chosen over traditional phosphate and other products when biodegradability is required by environmental regulation. In this regard, we create products that can be used by our NanoChem sales force to market to oil service company technicians on a oil well-by-oil well basis according to the specific water conditions involved.

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 bio-available 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 yield values significantly beyond the cost of the TPA used. We conduct sales of these TPA-specific products by distribution through agricultural input companies, with a current emphasis on the Western United States. These proteins are designated for crop nutrient management programs and should not be confused with crop protection and pesticides or other agricultural chemical application. Depending on the application, these 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 and reduce maintenance costs and lengthen equipment lifetimes. These TPAs can replace and compete with acid type scale removers, but have the competitive advantages of a positive yield effect on the plant, as well 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 our TPAs for 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 have to find ways to decrease the cost of goods sold or wait for legislative intervention regarding biodegradability of detergent components. In the meantime, we are researching various methods of reducing 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. It may also be used as an additive to toothpaste with the documented effect of reducing decay bacteria adhesion to tooth enamel

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and presumed reduction in total decay. We do not currently sell TPAs for personal care products into these markets.

COMPETITION

HEAT$AVR(R) and ECO$AVR(TM)

We are aware of only one other company that manufactures a chemical evaporation reduction product that competes with our HEAT$AVR(R) product. This other product has had limited sales to date and does not have the important convenience factor of our ECO$AVR(TM) product. In addition to this existing competitor, our previous distributor, Sun Solar Energy Technologies Inc. (hereinafter referred to as "Sun Solar"), has recently begun selling a product called Turbo-Tropical Fish that directly competes with our ECO$AVR(TM) product. This product, while having a higher price point and no sales history to date, must be taken seriously because of the expertise Sun Solar derived from working with us for six years as our exclusive North American distributor of ECO$AVR(TM), which relationship ended in February 2004. We also believe that Sun Solar is infringing our trademark rights by using the name "Turbo Tropical Fish" and we are actively litigating the issue.

As mentioned above, HEAT$AVR(R) also competes against plastic pool blanket products. We compete against pool blankets on the basis of convenience of use of HEAT$AVR(R) versus the inconvenience of deploying and storing pool blankets. Pool owners and operators may also decide that evaporation control products are not needed for their pools.

WATER$AVR(R)

Aegis Chemical Industries Ltd. of India directly competes with our WATER$AVR(R) product. We believe our WATER$AVR(R) product is superior for the following reasons:

- EASIER APPLICATION. WATER$AVR(R) may be deployed directly to the water surface by hand or machine. Our competition requires premixing to dilute the product to usable strength, followed by extensive pumping.

- COST. In order to achieve comparable water savings levels, other products would cost more than the WATER$AVR(R) product.

Water conservation is an important priority throughout the world, and numerous researchers in industry and academia are seeking to develop solutions that may compete with, or be superior to our products. Climate changes that relieve water shortage conditions or a technological breakthrough in water desalination could reduce the need for water conservation products.

WATER$AVR - BTI(TM)

We are not aware of any direct competition to our WATER$AVR - BTI(TM) product; however, the business of pest control is very large and very well funded. There are a multitude of methods and materials that can be used for mosquito control and all of them are competition for our product. We believe that we will be able to compete by:

- Providing an environmentally sensitive alternative;
- Increasing effectiveness per unit cost; and
- Reducing cost of application respective to similar products.

Biopolymers (TPAs)

Our TPA products have direct competition with Lanxess AG (recently spun out of Bayer AG), a German TPA manufacture of similar quality operating pursuant to a different patented process from that used by NanoChem. NanoChem and Lanxess have cross-licensed each other's processes and either company can use either process for the term of the patents involved. It is believed that Lanxess has approximately the same production capacity as NanoChem and it must be presumed that their cost of goods sold is competitive. 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 the advantage of flexibility because of the relative size of our company. In addition, we intend to continue to seek market niches that are not the primary targets of Lanxess, such that we can attempt to avoid confusion.

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

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

MANUFACTURING

Our HEAT$AVR(R) and ECO$AVR(TM) 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 our products and we do not have any long term supply contracts for any such items. We manufacture our products in an approximately 11,000 sq. ft. plant in Calgary, Alberta, Canada.

Our WATER$AVR(R) products are manufactured under contract with Ondeo Nalco Company ("Ondeo") under a five-year agreement effective as of April 2002, with a five-year extension available. We are not required to purchase any minimum quantity of such product.

Our 56,780 sq. ft. manufacturing facility in Peru, Illinois presently satisfies our TPA needs for our NanoChem subsidiary. Precursor chemicals for TPA production are sourced from various manufacturers throughout the world and we believe they are available in sufficient quantities for any expected increase in sales. The precursor chemicals are, however, derived from crude oil and are subject to price fluctuations related to world oil prices.

GOVERNMENTAL REGULATIONS

HEAT$AVR(R) and ECO$AVR(TM)

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

WATER$AVR(R)

Our WATER$AVR(R) product is subject to additional regulation in most countries, particularly for agricultural and drinking water uses. As we continue to develop this product, and prior to its full-scale commercial roll-out, we will address these issues on a country-by-country basis. We do not anticipate that governmental regulations will be an impediment to marketing our WATER$AVR(R) product because the ingredients have historically been used in agriculture for many years for other purposes. Nevertheless, we will need to obtain approval to sell WATER$AVR(R) in the United States for agricultural or drinking water users. To date, we have already applied for and received National Sanitation Foundation approval for drinking water in the United States.

WATER$AVR--BTI(TM)

As a new pesticide formulation, WATER$AVR--BTI(TM) must be approved by the United States Environmental Protection Agency ("EPA") and equivalent bodies in countries throughout the world where we will sell the product. An application for product approval was filed with the EPA in November 2004. It has been accepted for fast track status and the application fee has been waived. Fast track status requires the EPA to provide a decision within six months of accepting an application and, as such, an answer is expected by no later than May 2005. If the product is approved by the EPA, our subsidiary, WaterSavr, will proceed to apply for certification in any country where significant markets are identified.

Biopolymer Products (TPAs)

In the oil field and agricultural markets, NanoChem has applied for and received government approval in all areas of current use. As new markets are accessed, we will seek additional certification for such markets. We believe our NanoChem employees are experienced and skilled in the successful prosecution of these certifications.

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, that regulate TPA use. If we begin to market our TPA products to these industries, we will need to satisfy the regulatory approval requirements therefor.

PROPRIETARY RIGHTS

Our success and ability to compete is dependent, in part, upon our proprietary technology. We rely on a combination of patent, copyright and trade secret laws and nondisclosure agreements to protect our proprietary technology. We currently hold 56 U.S. patents and 139 International patents. We also have three U.S. patent applications pending and have applied to extend these pending patents to certain other countries where we operate. There can be no assurance that our pending 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

During the last two fiscal years, we have spent approximately $126,167 on research and development activities. 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, 2004, we had 34 employees, including one officer, twenty-two sales and customer support personnel, and eleven manufacturing personnel. None of our employees is represented by a labor union and we have experienced no work stoppages to date.

Item 2. Description of Property.

Our Chief Executive Officer provides use of space in his residence to conduct some of his administrative duties and we do not reimburse him for such use. We lease total space of 4,300 sq. ft. in Victoria, British Columbia for administration, sales and research space at $4,225 a month. This lease is effective through June 2009. We lease an 11,000 square feet building in Calgary, Alberta, Canada for $6,240 per month for manufacture of our swimming pool products. This lease is effective through September 2006. We lease 1,900 square feet in Richmond, British Columbia as additional space for sales and customer support at a cost of $1,870 per month. This lease is effective through January 2007. NanoChem leases 7,000 square feet in Bedford Park, Illinois as offices and laboratories at a cost of $7,367 monthly. This lease is effective through November 2005. NanoChem also owns 56,780 square feet of offices and factory in Peru, Illinois.

Item 3. Legal Proceedings.

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 return of 100,000 shares of our common stock and 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 return of such shares after defendant's 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. The proceeding is still in a discovery phase. 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 yet determinable.

On November 13, 2003, an ex-employee, Patrick Grant, filed a lawsuit in the Circuit Court of Cook County, Illinois against us, WaterSavr, and our Chief Executive Officer, Daniel B. O'Brien. The plaintiff claims damages for breach of contract, tortious interference with an agreement and various wrongful discharge claims. Mr. Grant 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. We consider the case to be without merit and are planning to dispute the matter vigorously. In addition, we 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 plaintiff's disclosure of confidential information to a client during his employment at WaterSavr. 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 Mr. Grant is not yet determinable.

On July 23, 2004, we filed a breach of contract suit in the Circuit Court of Cook County, Illinois against Tatko Biotech Inc. ("Tatko"). The action arises out of our joint product development agreement with Tatko in which the 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 have sought 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 District 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 May 28, 2004, Sun Solar filed a lawsuit in the Federal Court of Canada, against us, Flexible Ltd., and our Chief Executive Officer, Daniel B. 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 our further use of the "Tropical Fish" trademark; 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, Flexible Ltd. and Mr. O'Brien filed our defense and 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 we own the "Tropical Fish" trademark, or, in the alternative, the trademark 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 have been scheduled for July 2005. No amounts have been recorded as receivable in our consolidated financial statements and no amounts have been accrued as potential losses as the outcome of this claim is not determinable.

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

There were no matters submitted to the vote of our shareholders in the quarter ended December 31, 2004.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters.

MARKET FOR SECURITIES

Our common stock began trading on the American Stock Exchange under the symbol FSI on November 19, 2002. Prior to that, our stock traded on the over-the-counter market and was quoted on the NASD Electronic Bulletin Board.

The following is the range of high and low closing sales or bid prices for our common stock for the periods indicated:

		HIGH	LOW
YEAR ENDED DECEMBER 31, 2004	First Quarter	$5.20	$3.92
	Second Quarter	5.15	4.30
	Third Quarter	5.05	3.09
	Fourth Quarter	4.15	2.82
YEAR ENDED DECEMBER 31, 2003	First Quarter	3.40	2.25
	Second Quarter	3.40	2.39
	Third Quarter	3.60	2.90
	Fourth Quarter	5.35	3.00

Prices since November 19, 2002 represent high and low prices on the American Stock Exchange. Prices prior to November 19, 2002 represent inter-dealer quotations which do not include retail mark-ups, markdowns, or commissions, and do not necessarily represent actual transactions. As of December 31, 2004, we had 23 record holders of our common stock. Such shares are owned by an estimated 1,590 beneficial owners.

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

DIVIDEND POLICY

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 the board of directors in light of conditions then existing, including our earnings, financial condition, capital requirements and other factors.

EQUITY COMPENSATION PLAN INFORMATION

The following table contains certain information relating to outstanding options to purchase the Company's common stock granted pursuant to individual compensation arrangements as of December 31, 2004, the Company's most recently completed fiscal year.

PLAN CATEGORY	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS (A)	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS (B)
Equity compensation plans approved by security holders (1):	--	--
Equity compensation plans not approved by security holders (2):	1,241,740	$3.31
TOTAL	1,241,740	$3.31

(1) We have not granted any shares to purchase our common stock pursuant to equity compensation plans that have been approved by our shareholders.

(2) (a) Consists of non-qualified options to purchase our common stock that have been granted pursuant to individual compensation arrangements and not pursuant to any equity compensation plan. All of the grants made during our fiscal year are submitted for shareholder approval at such fiscal year's annual shareholder meeting and, to date, our shareholders have approved all of the grants.

(b) If the grantee is an employee, and if he or she ceases to be employed by us, the grantee may, during the 30-day period following termination of employment, exercise the option to the extent that the option was exercisable on the date of termination. In the case of death or disability, the grantee (or his or her administrator) has twelve months from the date of death or disability to exercise the option to the extent that the option was exercisable on the date of death or disability.

(c) The options are subject to adjustment by reason of a recapitalization, reclassification, stock split, combination of shares, dividend or other distribution payable in capital stock. Upon a merger, liquidation, dissolution or other consolidation, we shall provide each grantee with one-months' prior written notice informing the grantee that he or she may exercise the option in full (to the extent it has not been previously exercised) within such one-month period. Following such date, the options shall be terminated.

(d) The options may not be transferred, assigned, pledged or hypothecated in any way (except by will or the laws of descent) and are not subject to execution, attachment or similar process.

(e) All of the options granted have terms of between one and six years from and after the date of grant and reflect exercise prices equal to the fair market value of a share of our common stock as determined by our board of directors on the date of grant thereof. As set forth below, all of the options contain vesting provisions pursuant to which the options are 100% exercisable within a determinable number of months from and after the date of grant:

OPTIONS 100% EXERCISABLE WITHIN 12 MONTHS FROM AND AFTER THE DATE OF GRANT	OPTIONS 100% EXERCISABLE WITHIN 12 MONTHS FROM AND AFTER THE DATE OF GRANT (CONT.)	OPTIONS 100% EXERCISABLE WITHIN 24 MONTHS FROM AND AFTER THE DATE OF GRANT	W
A. Options: 250,000 Grant Date: 12.01.01 Vest Date: 12.01.01	H. Options: 12,000 Grant Date: 4.2.04 Vest Date: 12.31.04	A. Options: 5,000 Grant Date: 4.10.02 Vest Date: 12.31.03	A.
B. Options: 163,000 Grant Date: 12.31.02 Vest Date: 12.31.03	I. Options: 20,000 Grant Date: 5.21.04 Vest Date: 12.31.04	B. Options: 10,000 Grant Date: 4.23.03 Vest Date: 12.31.04	B.
C. Options: 50,000 Grant Date: 2.16.03 Vest Date: 12.31.03	J. Options: 25,000 Grant Date: 5.24.04 Vest Date: 12.31.04	C. Options: 50,000 Grant Date: 9.2.04 Vest Date: 9.2.06	C.
D. Options: 10,000 Grant Date: 4.23.03 Vest Date: 12.31.03	K. Options: 10,000 Grant Date: 6.14.04 Vest Date: 6.30.04	D. Options: 164,000 Grant Date: 11.26.03 Vest Date: 12.31.04	D.
E. Options: 5,000 Grant Date: 5.26.03 Vest Date: 12.31.03	L. Options: 50,000 Grant Date: 9.2.04 Vest Date: 9.2.05	E. Options: 221,000 Grant Date: 11.26.04 Vest Date: 12.31.05	--- O WI
F. Options: 2,000 Grant Date: 9.18.03 Vest Date: 9.18.03	M. Options: 5,000 Grant Date: 9.24.04 Vest Date: 12.31.04		--- A.
G. Options: 8,000 Grant Date: 3.15.04 Vest Date: 12.31.04			

Item 6. Management's Discussion and Analysis or Plan of Operation.

Our operating activities are related primarily to manufacturing and marketing our swimming pool conservation products.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Securities and Exchange Commission ("SEC") has recently issued Financial Reporting Release ("FRR") No. 60, Cautionary Advice Regarding Disclosure About Critical Accounting Policies, suggesting companies provide additional disclosure and commentary on those accounting policies considered most critical. A critical accounting policy is one that is both important to the portrayal of our financial condition and results, and requires management's most difficult, subjective or complex judgments. Typically, the circumstances that make these judgments difficult, subjective and/or complex have to do with the need to make estimates about the effect of matters that are inherently uncertain. We believe the accounting policies below represent our critical accounting policies as contemplated by FRR No 60 (see Note 3 of the Notes to Consolidated Financial Statements for a detailed discussion on the application of these and other accounting policies):

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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 our customers deteriorates resulting in an impairment of their ability to pay or a pattern of late payment develops, allowances 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.

RESULTS OF OPERATIONS

Separate financial data for each of the Company's operating segments is provided below. Segment Gross Profit Margin is defined in the discussion below. The Company evaluates the performance of the Company's operating segments based on the following:

	DECEMBER 31,				
	2004	2003	2002	% CHANGE 2004-2003	% 2
Sales					
Energy Segment	$ 1,015,018	$ 2,321,120	$ 1,112,192	(56%)	
Polymer Segment	2,377,919	--*	--*	--*	
Consolidated	3,392,937	2,321,120	1,112,192		
Gross Profit Margin					
Energy Segment	502,121	958,056	530,770	(48%)	
Polymer Segment	1,559,741	--*	--*	--*	
Consolidated	2,061,862	958,056	530,770		
SG&A					
Energy Segment	2,029,340	1,664,146	997,899	122%	
Polymer Segment	1,291,825	--*	--*	--*	
Consolidated	3,321,165	1,664,146	997,899		
Interest Income					
Energy Segment	34,258	203,310	67,228	(83%)	

Polymer Segment	--	--*	--*	--*
Consolidated	34,258	203,310	67,228	
Write-down of Investments				
Energy Segment	32,500	--	--	--
Polymer Segment	--	--*	--*	--*
Consolidated	32,500	--	--	--
Net Income (Loss)	$(1,257,545)	$(476,888)	$(378,445)	(264%)

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* Polymer segment data is not available as indicated. The Company's polymer segment was formed after the acquisition of certain assets of the Donlar Corporation in June 2004.

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YEAR ENDED DECEMBER 31, 2004 AND 2003

Sales for the year ended December 31, 2004 were $3,392,937 compared to $2,321,120 for the 2003 period, an increase of $1,071,817, or 46 %. The sales increase was primarily the result of the revenue provided by NanoChem, our new subsidiary formed from the assets acquired from the Donlar bankruptcy estate.

Our Energy segment had sales of $1,015,018 for the year ended December 31, 2004, as compared to $2,321,120 for the year ended December 31, 2003, a decrease of 56%. This decrease is primarily the result of substantial "Tropical Fish" product still in the market, which product is being sold by our discontinued distributor, Sun Soar, and our brand building efforts in connection with our ECO$AVR(R) product line. We expect revenue in this segment to increase in 2005 as brand recognition of our ECO$AVR(R) product line continues to grow and our marketing efforts of the WATER$AVR(R) product line begin to produce increased sales. Our Polymer segment achieved sales of $2,377,919 for the year ended December 31, 2004. There is no comparable data from the Polymer segment for the year ended December 31, 2003, because our Polymer segment was formed after the acquisition of certain assets of the Donlar Corporation in June 2004.

We had a loss of $1,257,545, or $0.11 per share, compared to a loss of $476,888 in 2003. The three largest contributors to the loss were:

- The brand building, marketing and extra staffing costs in ECO$AVR(TM) sales incurred throughout the year that were not reflected in sales because dealers that had been sold product by our discontinued distributor, Sun Solar, still had substantial "Tropical Fish" product. We believe that very little old product is on the shelves and that costs and revenue for ECO$AVR(TM) will be better balanced in 2005.

- All divisions maintained or increased sales and marketing costs in the fourth quarter in order to increase the probability of sales increases in all of 2005. We considered the extra costs necessary to position us for growth.

- Litigation costs became significant in 2004 compared to 2003 as a result of the need to protect our assets from suit. The costs are manageable, but we will make every effort to reduce these costs going forward without adversely affecting shareholder value.

Our overall gross profit margin on product sales increased to 60.8% in the year ended December 31, 2004, an increase from 41.3% in the year ended December 31, 2003. This increase in gross margin was primarily due to the addition of our Polymer segment, which achieved a gross profit margin of 65.6%. Our Energy segment achieved a gross profit margin of 49.5%, which is an increase of 8.2% over the year ended December 31, 2003.

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.

We incurred operating expenses in the year ended December 31, 2003 of $1,664,146. In fiscal 2004, we also increased sales and marketing costs in connection with our WATER$AVR(R) product, which was reflected in increased wages, office, rent, telecommunications and travel expenses. We incurred higher professional fees in the year ended December 31, 2004 primarily due to increased legal and accounting expenses and specific consultants directed at integrating the functions and sales of NanoChem as quickly as possible. Depreciation expense was $388,071 for the year ended December 31, 2004, as compared to $37,712 for the year ended December 31, 2003, reflecting depreciation for additional property and equipment added in fiscal 2004.

There was no income tax provision for the year ended December 31, 2004 as no tax installment payments were made during the year while we recorded an income tax benefit of $25,892 for the year ended December 31, 2003. Our Energy segment had interest income of $34,258 for the year ended December 31, 2004, compared to $203,310 for the year ended December 31, 2003, as we used capital to purchase assets and develop our business. There was a net loss of $1,257,545 for the year ended December 31, 2004, as compared to a loss of $476,888 for the year ended December 31, 2003.

With the addition of the Donlar assets, we became a much larger company with commensurate increases in most expense segments. However, certain expenses that were reduced such as travel ($132,632 for the year ended December 31, 2004, as compared to $150,116 for the year ended December 31, 2003) and telecommunications ($41,895 compared to $41,445 despite adding three new locations), as a result of more careful cost control in our WaterSavr subsidiary.

YEAR ENDED DECEMBER 31, 2003 AND 2002

The discussion in this section does not include a comparison of Polymer segment data for this period. Our Polymer segment was formed after the acquisition of certain assets of the Donlar Corporation in June 2004.

Sales for the year ended December 31, 2003 were $2,321,120, as compared to $1,112,192 for the year ended December 31, 2002, an increase of $1,208,928, or 109%. The sales increase was primarily the result of increased sales in residential swimming pool products, increased sales in the commercial swimming pool division, and the fiscal 2003 sales attributed to our WATER$AVR(R) product. In addition, we increased the price of our residential swimming pool product by

12.5% in the third quarter of fiscal 2003.

For fiscal 2003, our overall gross profit margin on product sales decreased to 41.3%, as compared to 47.7% in fiscal 2002. This decrease was primarily due to higher costs for employees, travel and product awareness efforts at our WaterSavr division in Illinois. There were also extra costs related to the labor and material inputs for our swimming pool products as a result of the significant rise of the Canadian Dollar versus the United States Dollar.

We incurred operating expenses for the year ended December 31, 2003 of $1,664,146, as compared to operating expenses of $997,899 for the year ended December 31, 2002. In the year ended December 31, 2003, we increased sales and marketing costs in connection with our WATER$AVR(R) product and this was reflected in increased wages, office, rent, telecommunications and travel expenses. We also incurred increased professional fees for the year ended December 31, 2002 due to increased legal and accounting expenses and specific consultants directed at increasing WATER$AVR(R) sales as quickly as possible in countries outside the United States. Depreciation expense was $37,712 for the year ended December 31, 2003, as compared to $24,683 for the year ended December 31, 2002, which reflects depreciation for additional property and equipment added in the year ended December 31, 2003. Our expenses to increase investor awareness were significantly more than in the year ended December 31,

2002 and this resulted in an increase in investor relations and transfer agent fees in the year ended December 31, 2003. We also had a credit of $31,955 in the year ended December 31, 2003 for currency exchange, as compared to an expense of $19,180 for such item in the year ended December 31, 2002.

Our income tax provision for the year ended December 31, 2003 reflected a benefit of $25,892, an increase over the year ended December 31, 2002 income tax benefit of $21,456. In the year ended December 31, 2003, we had interest income of $203,310.

We had a net loss of $476,888 in the year ended December 31, 2003, as compared to a net loss of $378,445 in the year ended December 31, 2002.

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:

	2004	2003	INCREASE (DECREASE)
Cash and cash equivalents	$ 558,795	$ 237,080	$ 321
Short-term investments	559,440	5,033,837	(4,474
Working capital	(101,121)	5,752,679	(5,853
Short-term loan	3,150,000	--	3,150

The overall decrease in short-term investments and cash and cash equivalents was primarily a result of cash used for the purchase of the assets comprising our NanoChem division. Cash was also used to market our WATER$AVR(R) product line, which has not yet attained significant sales to maintain positive cash flow. Our working capital has also decreased by $5,853,800 as a result of acquiring the assets comprising our NanoChem division and assuming a short-term loan for the purchase of such assets. As shown, the short-term loan was $3,150,000 from nil in the previous year. Without this loan we would have had substantial working capital.

Historically, prior to fiscal 2004, our operations have been cash flow positive after considering the add back to net income of the stock-based compensation expense and depreciation. In the year ended December 31, 2004, our operations generated negative cash flow as we acquired a large amount of inventory and we financed the purchase of NanoChem division assets through the redemption of short-term investments. In order to build our business, develop and research our products and sustain our start-up operations, we have relied mainly on external equity financing. We intend over the next two quarters to obtain additional external equity financing to repay the short-term debt, which is due in June 2005, and continue to develop our products.

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.

Other than to repay or replace the short-term loan due in June 2005, 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 US patents to select other countries. Approximately 80% of such expenditures are related to our WATER$AVR(R) product line.

There can be no assurance that any of the expenditures will result in additional sales revenues. In the event that our capital resources are not sufficient for our continued expansion, 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 us or at all. There are no investment banking agreements in place at this time.

RESTATED FINANCIAL STATEMENTS

The accompanying financial statements have been restated to correct stock-based compensation expense. In October 2005, while completing a registration statement for securities issued in the second quarter of 2005, we determined that certain disclosures made in connection with our stock-based compensation expense required adjustment. In September 2002, we entered into a distribution agreement with Ondeo whereby Ondeo agreed to serve as the exclusive distributor of our WATER$AVR(R) products for so long as Ondeo maintained a certain threshold sales level as defined in the agreement. As consideration for signing the agreement, Ondeo was granted an option to purchase 2,000,000 shares of our common stock. Half of the option for one million shares was exercisable immediately at an exercise price of $4.25 for each common share. The remaining half of the option for 1,000,000 shares was exercisable after certain threshold sales targets were achieved at a price of $5.50 for each common share.

In determining the stock-based compensation expense for the nine months ended September 30, 2002, we expensed the entire fair value of the stock option believing that the option fully vested upon the signing of the agreement. In our October 2005 review, however, we determined that: (i) first, as stated above, half of the option to purchase 1,000,000 shares of common stock did not vest and was not exercisable until the threshold sales target had been met, which would not be until five years after the signing of the distribution agreement; and (ii) second, we did not consider Emerging Issues Task Force ("EITF") No. 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services; EITF No. 00-18, Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees; and EITF No. 01-9, Accounting for Consideration Given by a Vendor to a Customer.

During the three months ended March 31, 2003, Ondeo achieved the first threshold sales target, and accordingly, we should have recorded a corresponding stock-based compensation expense of $54,080. However, since the entire stock-based compensation expense had been recorded in the September 30, 2002 interim financial statements and in the year ended December 31, 2002, we did not record any additional stock-based compensation expense as a result of the attained first threshold level.

In the fourth quarter of the year ended December 31, 2003, we determined that Ondeo was not going to attain the minimum sales targets stipulated in the agreement. Consequently, the agreement and corresponding stock option was cancelled. We accounted for the cancellation of the stock option in accordance with Statement of Financial Accounting Standard No. 123 similar to a forfeiture of stock options and reversed $2,480,200 of the stock-based compensation expense previously recorded in fiscal 2002. Had we accounted for the cancellation of the stock option correctly, we would have reversed the amended stock-based compensation expense of $54,080 that was recorded in the first quarter ended March 31, 2003.

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

1. Approximately $2,704,000 in stock-based compensation expense recorded in September 2002 has been reversed;

2. Approximately $54,080 in stock-based compensation expense has been recorded in the quarter ended March 31, 2003, as Ondeo met the first sales threshold under the agreement;

3. Approximately $54,080 in stock-based compensation expense has been reversed in the year ended December 31, 2003, as Ondeo failed to meet subsequent sales thresholds under the agreement, resulting in the cancellation of the stock option;

4. As stated above, we previously recorded a stock-based compensation expense of $2,704,000 in December 2002. As a result of canceling the stock option, we previously recorded a recovery of $2,480,000 of stock-based compensation expense at December 31, 2003. This $2,480,000 recovery has been reversed, in conjunction with the reversal of $2,704,000 in stock-based compensation expense originally recorded; and

5. For the periods ended March 31, 2004 to June 30, 2005, the net effect of these adjustments is to decrease capital in excess of par value by approximately $223,800 and increase retained earnings by approximately $223,800.

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

RISK FACTORS

RISKS RELATED TO OUR BUSINESS

WE HAVE A LIMITED OPERATING HISTORY UPON WHICH TO EVALUATE OUR POTENTIAL FOR FUTURE SUCCESS.

Although we were incorporated in 1991, we have been operating in our present form only since May 1998. To date, we have generated limited revenues from the sale of our products and do not expect to generate significant revenues until we sell a significantly larger number of our products. Accordingly, we have only a limited operating history upon which you can base an evaluation of our business and prospects. The likelihood of our success must be considered in light of the risks and uncertainties frequently encountered by middle stage companies like ours in an evolving market. If we are unsuccessful in addressing these risks and uncertainties, our business will be materially harmed.

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 since our inception and we currently have an accumulated deficit. To the extent that our revenues do not increase, our results of operations and liquidity will be materially adversely affected. If we experience slower than anticipated revenue growth or if our operating expenses exceed our expectations, we may not achieve profitability. Even if we achieve profitability in the future, we may not be able to sustain it.

FLUCTUATIONS IN OUR OPERATING RESULTS MAY CAUSE OUR STOCK PRICE TO DECLINE.

Given the nature of the markets in which we participate, 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 industries, such as swimming pool construction, on which we are particularly dependent;
- changes in the portions of our revenue represented by various

products and customers;

- o delays or problems in the introduction of new products;
- o the announcement or introduction of new products, services or technological innovations by our competitors;
- o variations in our product mix;
- o the timing and amount of our expenditures in anticipation of future sales;
- o increased costs of raw materials or supplies; and
- o changes in the volume or timing of product orders.

WE HAVE NOT PAID, AND DO NOT EXPECT TO PAY, DIVIDENDS ON OUR COMMON STOCK.

We have not paid any dividends on our common stock since our inception and do not intend to pay any dividends to our common shareholders in the foreseeable future. We intend to reinvest any earnings in the development and expansion of our business.

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 WATER$AVR(R) product are also seasonal, dependent 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.

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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 WATER$AVR(R) 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 WATER$AVR(R) product may result in continued losses. We introduced our WATER$AVR(R) product in June 2002 and, to date, we have delivered quantities for testing by potential customers, but only one customer has 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 $400,000 on the marketing and production of our WATER$AVR(R) product in fiscal 2005.

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 six that are sizable enough that the loss of any one would be significant. Any such loss of one or more of these customers could result in a substantial reduction in our revenues. For this reason, we concentrate on maintaining good sales relations with these customers. We also try and minimize this risk by seeking out new customers.

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OUR ACQUISITION ACTIVITIES COULD DISRUPT OUR ONGOING BUSINESS.

In June 2004, our subsidiary, NanoChem, completed the acquisition of Donlar Corporation, which provided us with domestic and international patents relating to environmental products and technologies, as well as a 56,780 sq. ft. manufacturing plant on 40 acres of property in an area outside of Chicago, Illinois. Acquisitions such as these often involve risks, including: (i) disruption of our ongoing business; and (ii) an inability to successfully integrate the acquired technologies and operations into our businesses and maintain uniform standards, controls, policies and procedures. In addition, in order to finance future acquisitions, we may have to raise additional funds, through either public or private financings. We may be unable to obtain such funds or may be able to do so only on unfavorable terms.

ECONOMIC, POLITICAL, AND OTHER RISKS ASSOCIATED WITH INTERNATIONAL SALES AND OPERATIONS COULD ADVERSELY AFFECT OUR SALES.

In the year ended December 31, 2004, revenues from shipments made outside of the United States accounted for approximately 65% of our revenues, 10% in the year ended December 31, 2003 and 10% in the year ended December 31, 2002. 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's 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 protection of intellectual property and changes in that protection; 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 shipment of product we make to them. 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. While we have exposure to this type of risk, we are no longer subject to the concentrated credit risk that we were previously subject to because of our relationship with Sun Solar Technologies. In addition, while our exposure to a bad debts and write-offs credit risk may increase as we service a larger number of customers in the swimming pool and personal spa, water evaporation and TPA industries, the effect of any such bad debts and write-offs will be minimized as a result of the increase in the numbers of our customers and overall revenues.

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 to be viewed as being 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 certain of our chemical substances. 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 the imposition of 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, Sun Solar, 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. Accordingly, we are doing all that we can to ensure our proprietary products and technologies are not used by them (or others) without our permission.

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 patent 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 personal spa 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 executive 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 the employees required for it to be successful, there can be no assurance that we will be able to retain the services of all of our key employees or a sufficient number to execute on our plans, nor can there be any assurances that we will be able to continue to attract new employees as required.

Item 7. Financial Statements.

Our consolidated financial statements and notes thereto appear on pages F-1 to F-20 of this Annual Report.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC. AND SUBSIDIARIES
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the board of directors and stockholders of
FLEXIBLE SOLUTIONS INTERNATIONAL, INC.:

We have audited the consolidated balance sheet of Flexible Solutions

International, Inc. as at December 31, 2004 and 2003 and the consolidated statements of operations, stockholders' equity and cash flows for the years then ended. The consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion the consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2004 in conformity with generally accepted accounting principles in the United States of America.

As described in note 3 to the consolidated financial statements, the accompanying consolidated financial statements of Flexible Solutions International, Inc. as of December 31, 2004 and 2003 and for the years then ended have been restated.

On February 11, 2005 (September 30, 2005 as to the effects of the restatements described in note 3), we reported separately to the shareholders of Flexible Solutions International, Inc. on consolidated financial statements for the same period, audited in accordance with auditing standards generally accepted in the United States of America and prepared in accordance with accounting principles generally accepted in the United States of America.

Cinnamon Jang Willoughby & Company,
Chartered Accountants

Burnaby, British Columbia
March 15, 2004 (September 30, 2005 as to the effects of the restatements described in note 2)

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
AT DECEMBER 31, 2004
(U.S. DOLLARS)

	DECEMBER 31, 2004	DECEMBER 31, 2003

		AS RESTATED (NOTE 3)		AS RESTATED (NOTE 3)
ASSETS				
CURRENT				
Cash and cash equivalents	$	558,795	$	237,08
Short-term investments		559,440		5,033,83
Accounts receivable		501,372		294,23
Income tax receivable		92,963		86,24
Loan receivable		38,570		17,58
Inventory		1,416,588		212,93
Prepaid expenses		131,280		36,10
		3,299,008		5,918,02
PROPERTY AND EQUIPMENT		5,250,346		167,58
INVESTMENT		271,000		303,50
	$	8,820,354	$	6,389,11
LIABILITIES				
CURRENT				
Due to shareholders	$	--	$	7,70
Short-term loan		3,150,000		
Accounts payable and accrued liabilities		250,129	$	157,64
		3,400,129		165,34
STOCKHOLDERS' EQUITY				
CAPITAL STOCK				
Authorized				
50,000,000 Common shares with a par value of $0.001 each				
1,000,000 Preferred shares with a par value of $0.01 each				
Issued and outstanding				
11,831,916 (2003: 11,794,916) common shares		11,832		11,79
CAPITAL IN EXCESS OF PAR VALUE		7,439,621		7,082,81
OTHER COMPREHENSIVE INCOME (LOSS)		100,179		3,02
DEFICIT		(2,131,407)		(873,86
TOTAL STOCKHOLDERS' EQUITY		5,420,225		6,223,76
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	8,820,354	$	6,389,11

SEE COMMITMENTS AND CONTINGENCIES (NOTE 16 & 17)

- See Notes to Consolidated Financial Statements -

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003
(U.S. DOLLARS)

	YEAR ENDED DECEM
	2004

	AS RESTATED (NOTE 3)
SALES	$ 3,392,937
COST OF SALES	1,331,075
GROSS PROFIT	2,061,862
OPERATING EXPENSES	
Wages	932,283
Administrative salaries and benefits	133,120
Advertising and promotion	97,946
Investor relations and transfer agent fee	215,670
Office and miscellaneous	166,099
Insurance	73,375
Interest expense	68,384
Rent	177,667
Consulting	398,753
Professional fees	308,534
Travel	132,632
Telecommunications	41,895
Shipping	28,866
Research	58,552
Commissions	9,578
Bad debt expense (recovery)	(10)
Currency exchange	20,000
Utilities	69,750
Depreciation	388,071
	3,321,165
INCOME (LOSS) BEFORE OTHER ITEMS AND INCOME TAX	(1,259,303)
INTEREST INCOME	34,258
WRITE DOWN OF INVESTMENT	(32,500)
INCOME (LOSS) BEFORE INCOME TAX	(1,257,545)
INCOME TAX (RECOVERY)	--
NET INCOME (LOSS)	(1,257,545)
DEFICIT, BEGINNING	(873,862)
DEFICIT, ENDING	$ (2,131,407)
NET INCOME (LOSS) PER SHARE	$ (0.11)
WEIGHTED AVERAGE NUMBER OF SHARES	11,827,734

- See Notes to Consolidated Financial Statements -

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED DECEMBER 31, 2004 AND 2003
(U.S. DOLLARS -- UNAUDITED)

	THREE MONTHS ENDED
	2004
SALES	$ 981,012
COST OF SALES	501,761
GROSS PROFIT	479,251
OPERATING EXPENSES	
Wages	325,341
Administrative salaries and benefits	38,147
Advertising and promotion	24,688
Investor relations and transfer agent fee	42,506
Office and miscellaneous	12,046
Insurance	39,900
Interest expense	39,020
Rent	62,956
Consulting	104,644
Professional fees	96,388
Travel	52,801
Telecommunications	13,431
Shipping	6,916
Research	37,552
Commissions	9,578
Bad debt expense (recovery)	787
Currency exchange	14,334
Utilities	23,280
Depreciation	28,535
	972,850
INCOME (LOSS) BEFORE OTHER ITEMS AND INCOME TAX	(493,599)
INTEREST INCOME	794
WRITE DOWN OF INVESTMENT	(32,500)
INCOME (LOSS) BEFORE INCOME TAX	(525,305)
INCOME TAX (RECOVERY)	--
NET INCOME (LOSS)	(525,305)
DEFICIT, BEGINNING	(1,606,102)
DEFICIT, ENDING	$ (2,131,407)
NET INCOME (LOSS) PER SHARE	$ (0.04)
WEIGHTED AVERAGE NUMBER OF SHARES	11,831,916

- See Notes to Consolidated Financial Statements -

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003
(U.S. DOLLARS)

	YEAR ENDED D
	2004
OPERATING ACTIVITIES	
Net income (loss)	$ (1,257,545)
Stock compensation expense	299,345
Depreciation	388,071
Write down of investments	32,500
Changes in non-cash working capital items:	
Accounts receivable	438,490
Inventory	(907,869)
Prepaid expenses	(39,091)
Accounts payable	92,486
Income tax receivable	(6,720)
Decrease in due to shareholders	(7,700)
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	(968,033)
INVESTING ACTIVITIES	
Acquisition of property and equipment	(123,908)
Acquisition of the assets of Donlar Corporation	(3,194,412)
Short-term investments	4,474,397
Loan receivable	(20,985)
CASH USED IN INVESTING ACTIVITIES	1,135,092
FINANCING ACTIVITY	
Subscriptions received	--
Proceeds from issuance of common stock	57,500
CASH PROVIDED BY FINANCING ACTIVITIES	57,500
Effect of exchange rate changes on cash	97,156
INFLOW (OUTFLOW) OF CASH	321,715
Cash and cash equivalents, beginning of period	237,080
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 558,795
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION	
Income taxes paid	$ --
Interest received	34,258

- See Notes to Consolidated Financial Statements -

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2004
(U.S. DOLLARS)

	SHARES	PAR VALUE	CAPITAL IN EXCESS OF PAR VALUE AS RESTATED (NOTE 3)	SHARE SUBSCRIPTION RECEIVABLE	ACCUMULA EARNIN (DEFICIE AS RESTA (NOTE
Balance December 31, 2002	11,570,916	$ 11,570	$ 6,624,648	$ (16,217)	$ (396,
Translation adjustment	--	--	--	--	
Net income	--	--	--	--	(476,
Comprehensive income	--	--	--	--	
Shares issued					
Exercise of stock options	124,000	124	64,695	--	
For investment	100,000	100	270,900	--	
Payment of subscription receivable	--	--	--	16,217	
Stock option compensation	--	--	122,570	--	
Balance December 31, 2003	11,794,				