

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2010 and 2009

DYADIC INTERNATIONAL, INC.
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DECEMBER 31, 2010 AND 2009

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of Dyadic International, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Dyadic International, Inc. and Subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dyadic International, Inc. and Subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2010 in conformity with U.S. generally accepted accounting principles.



Boca Raton, Florida
March 7, 2011

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31,	
ASSETS	2010	2009
Current Assets:		
Cash and Cash Equivalents	\$ 4,535,279	\$ 8,419,934
Restricted Cash	247,082	316,129
Accounts Receivable, Net	1,276,574	1,376,034
Inventory, Net	2,782,433	2,820,381
Prepaid Expenses and Other Current Assets	336,638	420,654
Total Current Assets	9,178,006	13,353,132
Fixed Assets, Net	719,161	839,639
Intangible Assets, Net	310,978	148,167
Other Assets	16,930	16,930
	\$ 10,225,075	\$ 14,357,868
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	\$ 1,801,123	\$ 1,949,038
Accrued Expenses	417,996	713,163
Accrued Stockholder Litigation	-	3,250,000
Accrued Interest Payable	146,230	59,838
Note Payable to Stockholder	1,424,941	1,424,941
Income Taxes Payable	168	767
Total Current Liabilities	3,790,458	7,397,747
Convertible Subordinated Debt	4,000,000	-
	7,790,458	7,397,747
COMMITMENTS AND CONTINGENCIES		
Stockholders' Equity:		
Preferred Stock, \$.0001 Par Value:		
Authorized Shares – 5,000,000; None Issued and Outstanding	-	-
Common Stock, \$.001 Par Value,		
Authorized Shares – 100,000,000; Issued and Outstanding –		
31,138,120 and 30,613,995, Respectively	31,138	30,614
Additional Paid-In Capital	77,101,690	76,075,899
Stock to be Issued	-	23,887
Accumulated Deficit	(74,698,211)	(69,170,279)
Total Stockholders' Equity	2,434,617	6,960,121
	\$ 10,225,075	\$ 14,357,868

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,	
	2010	2009
Revenue:		
Product Related Revenue, Net	\$ 7,389,793	\$ 6,800,071
License Fee Revenue	37,250	10,300,000
Research and Development Revenue	<u>1,010,559</u>	<u>4,321,258</u>
Total Revenue	8,437,602	21,421,329
Cost of Goods Sold	<u>6,497,935</u>	<u>6,292,411</u>
Gross Profit	<u>1,939,667</u>	<u>15,128,918</u>
Expenses:		
General and Administrative	5,157,755	4,334,190
Sales and Marketing	988,453	958,143
Research and Development	1,240,510	1,211,035
Foreign Currency Exchange Losses, Net	<u>148,423</u>	<u>56,455</u>
Total Expenses	<u>7,535,141</u>	<u>6,559,823</u>
Income (Loss) from Operations	<u>(5,595,474)</u>	<u>8,569,095</u>
Other Income (Expense)		
Interest Income	61,573	141,811
Interest Expense	(248,319)	(219,892)
Loss on Stockholder Litigation	-	(3,250,000)
Gain on Reduction of Accrued Stockholder Litigation	410,000	-
Other	<u>(155,712)</u>	<u>-</u>
Total Other Income (Expense)	<u>67,542</u>	<u>(3,328,081)</u>
Net Income (Loss)	<u>\$ (5,527,932)</u>	<u>\$ 5,241,014</u>
Net Income (Loss) per Common Share:		
Basic	<u>\$ (0.18)</u>	<u>\$ 0.17</u>
Diluted	<u>\$ (0.18)</u>	<u>\$ 0.16</u>
Weighted Average Common Shares Used in Calculating Net Income (Loss) per Share:		
Basic	<u>31,011,137</u>	<u>30,121,396</u>
Diluted	<u>31,011,137</u>	<u>33,231,170</u>

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	<u>Common Stock</u>		<u>Additional</u>	<u>Stock to Be</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid In Capital</u>	<u>Issued</u>	<u>Deficit</u>	
Balance at December 31, 2008	29,990,675	\$ 29,991	\$ 75,843,581	\$ -	\$ (74,411,293)	\$ 1,462,279
Amortization of Deferred Compensation on Employee and Nonemployee Stock Options	-	-	118,103	-	-	118,103
Issuance of Stock for Consulting Services and Rent	80,136	80	31,441	-	-	31,521
Issuance of Stock for Stock Options Exercised	107,000	107	15,943	-	-	16,050
Issuance of Stock for Warrants Exercised	436,184	436	66,831	-	-	67,267
Stock to Be Issued - Stock Options	-	-	-	4,500	-	4,500
Stock to Be Issued - Warrants	-	-	-	19,387	-	19,387
Net Income	-	-	-	-	5,241,014	5,241,014
Balance at December 31, 2009	30,613,995	30,614	76,075,899	23,887	(69,170,279)	6,960,121
Amortization of Deferred Compensation on Employee and Nonemployee Stock Options	-	-	888,147	-	-	888,147
Issuance of Stock for Consulting Services	30,000	30	62,970	-	-	63,000
Issuance of Stock for Stock Options Exercised	252,375	252	38,887	(4,500)	-	34,639
Issuance of Stock for Warrants Exercised	241,750	242	35,787	(19,387)	-	16,642
Net (Loss)	-	-	-	-	(5,527,932)	(5,527,932)
Balance at December 31, 2010	<u>31,138,120</u>	<u>\$ 31,138</u>	<u>\$ 77,101,690</u>	<u>\$ -</u>	<u>\$ (74,698,211)</u>	<u>\$ 2,434,617</u>

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,	
	2010	2009
Operating Activities		
Net Income (Loss)	\$ (5,527,932)	\$ 5,241,014
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by (Used In)		
Operating Activities:		
Depreciation and Amortization of Fixed Assets	309,162	294,194
Amortization of Intangible and Other Assets	18,142	14,253
Reduction of Allowance for Doubtful Accounts	(55,818)	(55,550)
Reduction of Inventory Reserve	(418,406)	(842,587)
Compensation Expense on Stock Option Grants	888,147	118,103
Stock Issued for Consulting Services	63,000	31,521
Loss on Stockholder Litigation	-	3,250,000
Gain on Reduction of Accrued Stockholder Litigation	(410,000)	-
Changes in Operating Assets and Liabilities:		
Accounts Receivable	155,278	183,716
Inventory	456,354	1,797,956
Prepaid Expenses and Other Current Assets	84,016	216,548
Other Assets	-	120,573
Accounts Payable	(147,915)	(729,756)
Accrued Expenses	(295,167)	387,529
Accrued Interest Payable	86,392	(134,422)
Accrued Stockholder Litigation	(2,840,000)	-
Deferred Research and Development Obligation	-	(3,332,863)
Income Taxes Payable	(599)	(7,892)
	<u>(7,635,346)</u>	<u>6,552,337</u>
Net Cash Provided by (Used In) Operating Activities		
Investing Activities		
Purchases of Fixed Assets	(188,684)	(94,376)
Patent Costs	(180,953)	-
Restricted Cash	69,047	28,227
	<u>(300,590)</u>	<u>(66,149)</u>
Net Cash (Used In) Investing Activities		
Financing Activities		
Repayment of Note Payable to Stockholder	-	(1,000,000)
Proceeds from Issuance of Convertible Subordinated Debt	4,000,000	-
Proceeds from Stock Warrant Exercises	16,642	86,654
Proceeds from Stock Option Exercises	34,639	20,550
	<u>4,051,281</u>	<u>(892,796)</u>
Net Cash (Used In) Provided by Financing Activities		
Net Increase (Decrease) in Cash and Cash Equivalents	(3,884,655)	5,593,392
Cash and Cash Equivalents at Beginning of Year	<u>8,419,934</u>	<u>2,826,542</u>
Cash and Cash Equivalents at End of Year	<u>\$ 4,535,279</u>	<u>\$ 8,419,934</u>
Supplemental Cash Flow Information:		
Cash Paid for Interest	<u>\$ 161,927</u>	<u>\$ 354,314</u>

The Accompanying Notes are an Integral Part of these Consolidated Financial Statements

Dyadic International, Inc. and Subsidiaries Notes to Consolidated Financial Statements

Note 1: Organization and Operations

General

Dyadic International, Inc. (the “Company” or “Dyadic”) is a global biotechnology company headquartered in Jupiter, Florida with operations in the United States (“U.S.”) and The Netherlands. Dyadic has 36 full-time employees, 19 of which are dedicated to research and development (“R&D”) activities at the Company’s laboratories in Florida, North Carolina and The Netherlands.

Dyadic uses its patented and proprietary technologies to conduct R&D and commercial activities for the discovery, development, manufacture and sale of enzymes and proteins for the bioenergy, industrial enzyme, and biopharmaceutical industries. Dyadic recognizes substantially all of its revenues from (1) licensing its patented and proprietary technologies; (2) selling of its proprietary enzymes; and (3) conducting R&D activities for third parties.

Dyadic’s R&D activities focus on its patented and proprietary fungal strains and associated technologies. In particular, Dyadic uses its *Trichoderma* and C1 fungal strains in the production of its industrial enzymes. Dyadic manufactures and sells liquid and dry enzyme products to global customers for use within the animal feed, pulp and paper, starch and alcohol, food and brewing, textiles, and alternative fuels industries.

Dyadic also utilizes an integrated technology platform based on its patented and proprietary C1 fungus (the “C1 Platform Technology”) which enables the development and large-scale manufacture of low cost proteins and enzymes for diverse market opportunities. The C1 Platform Technology can also be used to screen for the discovery of novel genes and proteins. Dyadic aggressively pursues licensing arrangements and other commercial opportunities to leverage the value of these technologies by providing its partners and collaborators with the benefits of developing, manufacturing and/or utilizing the proteins and enzymes which these technologies help produce.

In the bioenergy industry, Dyadic’s primary focus is to continuously improve its C1 Platform Technology for the development of novel enzymes that will efficiently convert biomass into the maximum quantity of fermentable sugars at the lowest cost. These fermentable sugars, derived from agricultural residues and energy crops, can be used to produce cellulosic ethanol and butanol as well as chemicals, polymers and plastics and may provide a renewable cost-effective alternative to petroleum and petroleum-based products in a variety of industries.

In addition to facilitating the development and production of enzymes, the C1 Platform Technology also has the potential of performing the same function for other biological products in the biopharmaceutical industry such as antibodies, vaccines, proteins and polypeptides. By utilizing a proprietary host organism, the C1 Platform Technology may be used as a “one-stop shop” to discover, develop, and express the genes of complex living organisms which can then be manufactured for commercial applications.

The Company’s current patent portfolio consists of ten U.S. and 74 foreign patents, ten pending U.S. and 23 pending foreign patent applications as well as numerous U.S. and foreign publications, including, but not limited to, 11 international patent cooperation treaty (PCT) publications. The Company, as it deems appropriate based on a cost-benefit analysis, may periodically decide to abandon or forego pursuing certain patent applications. In addition, the Company has developed an extensive body of

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 1: Organization and Operations (Continued)

General (Continued)

technical know-how regarding R&D of various fermentation technologies from scale-up to large-scale commercialization which the Company protects through confidentiality and other agreements which contain restrictive covenants.

Dyadic anticipates that its products and technologies will become more widely accepted and utilized as awareness grows of the financial, operational, environmental and other advantages of applying biological solutions such as enzymes to manufacturing processes.

The Company expects to incur losses over the next several years as it continues to develop its products and technologies. However, there can be no assurance that the Company's efforts with regard to such development will be successful.

There is no assurance that the Company will be able to secure licensing transactions, or other collaborations, or the timing of those transactions going forward. This uncertainty may cause revenues to vary significantly from period to period, affecting the comparability of the consolidated financial statements.

Organizational History

The Company was incorporated in Delaware in September 2002 under its former name, CCP Worldwide, Inc. ("CCP Worldwide"). The Company is a holding company that holds all of the outstanding stock of Dyadic International (USA), Inc., a Florida corporation ("Dyadic-Florida"). Dyadic-Florida owns all of the outstanding stock of Geneva Investment Holdings Limited, a company organized under the laws of the British Virgin Islands ("Geneva"), Dyadic Nederland BV, a company organized under the laws of the Netherlands ("Dyadic NL") and Dyadic International Sp. z o.o., a company organized under the laws of Poland ("Dyadic-Poland").

In April 2001, Dyadic-Florida formed Dyadic-Poland for the purpose of managing and coordinating the Company's contract manufacturing of industrial enzymes in Poland and to assist in the marketing and distribution of those products. Dyadic-Poland ceased operations in 2010 and is now a dormant company under Polish law.

In January 2003, Dyadic-Florida formed Dyadic NL for the development, use and marketing of the C1 Platform Technology.

In October 2004, CCP Worldwide entered into an Agreement of Merger and Plan of Reorganization with Dyadic-Florida, a then privately-held Florida company (formerly known as Dyadic International, Inc.) and CCP Acquisition Corp., a wholly owned subsidiary of CCP Worldwide (the "Merger") whereby CCP Acquisition Corp. was merged with and into Dyadic-Florida. As a result of the Merger and in exchange for all of the outstanding shares of Dyadic-Florida, shareholders of Dyadic-Florida received shares of CCP Worldwide on a one-for-one basis which resulted in Dyadic-Florida becoming a wholly owned subsidiary of CCP Worldwide. CCP Worldwide then changed its name to Dyadic International, Inc. and Dyadic-Florida changed its name to Dyadic International (USA), Inc. For financial accounting purposes, the Merger was treated as an acquisition by Dyadic-Florida of CCP Worldwide.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 1: Organization and Operations (Continued)

Historical Results of Operations

The Company incurred a net loss in 2010 of \$5,527,932, or (\$0.18) fully-diluted earnings per share. In 2009, the Company generated a net income of \$5,241,014 or \$0.16 fully-diluted earnings per share. The Company attributes the majority of its profit in 2009 to revenues associated with licensing and funded R&D transactions, while attributing much of its operating losses in the current year to discretionary R&D expenditures to improve the C1 Platform Technology and other proprietary technologies and certain legal expenses. In prior years, the Company has incurred losses from operations which have resulted in an accumulated deficit of \$74,698,211 and \$69,170,279 as of December 31, 2010 and 2009, respectively. In order to advance its technologies and to develop new products, the Company has continued to incur discretionary R&D expenditures which the Company believes will continue in 2011 and beyond.

Market for Common Stock

Since January 16, 2008, the Company's common stock has traded on the OTC Markets (formerly known as the Pink Sheets), an electronic quotation and trading system for securities traded over-the-counter, under the ticker symbol "DYAI." The Company has no influence or control over quotations or trading on the OTC Markets, or with respect to any activities of market makers, and there can be no assurance that any purchases or sales of the Company's common stock on the OTC Markets has or will reflect true value. There also can be no assurance that a market in the Company's shares (whether on the OTC Markets or any other trading or quotation system) will develop or, if such a market develops, that it will continue.

Note 2: Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intra-entity transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the accompanying consolidated financial statements. Actual results could differ from those estimates, and those differences could be material.

Cash and Cash Equivalents

The Company considers as cash equivalents all interest-bearing deposits or investments with original maturities of three months or less when purchased.

Restricted Cash

The Company had restricted cash of approximately \$247,000 and \$316,000 at December 31, 2010 and 2009, respectively, which is reserved for the build-out of the Company's laboratory in The Netherlands (*Note 5*). One fifth of the outstanding restricted cash balance is refunded to the Company each year on the lease anniversary date through its expiration. The five year lease term expires on August 31, 2012.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 2: Summary of Significant Accounting Policies (Continued)

Accounts Receivable

Accounts receivable are recorded at their net realizable value on the date revenue is recognized. The Company provides allowances for doubtful accounts for estimated losses resulting from the inability of its customers to repay their obligations. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to repay, additional allowances may be required.

The Company provides for potential uncollectible accounts receivable based on specific customer identification and historical collection experience, adjusted for existing market conditions. If market conditions decline or the Company's customers experience economic difficulties, actual collections may not meet expectations and may result in decreased cash flows and increased bad debt expense.

The policy for determining past due status is based on the contractual payment terms of each customer, which are generally net 30, 60, or 90 days. Once collection efforts by the Company are exhausted, the determination for charging off uncollectible receivables is made. The Company does not accrue finance or interest charges on past due accounts receivable.

Accounts receivable consisted of the following at December 31:

	<u>2010</u>	<u>2009</u>
Accounts receivable	\$ 1,432,786	\$ 1,588,064
Less: allowance for doubtful accounts	<u>(156,212)</u>	<u>(212,030)</u>
	<u>\$ 1,276,574</u>	<u>\$ 1,376,034</u>

Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk include cash and cash equivalents and uncollateralized accounts receivable (*Note 9*). The Company invests its excess cash in money market funds.

Inventory

Inventory consists of raw materials and finished goods, including industrial enzymes used in the industrial, chemical, and agricultural markets, and is stated at the lower of cost or market using the weighted average cost method. The value of finished goods is comprised of raw materials and manufacturing costs, substantially all of which are incurred pursuant to agreements with independent manufacturers. Provisions have been made to reduce excess or obsolete inventory to net realizable value.

Inventory consisted of the following at December 31:

	<u>2010</u>	<u>2009</u>
Finished goods	\$ 2,860,435	\$ 3,147,516
Raw materials	47,387	216,660
	<u>2,907,822</u>	<u>3,364,176</u>
Less: reserve for obsolescence	<u>(125,389)</u>	<u>(543,795)</u>
	<u>\$ 2,782,433</u>	<u>\$ 2,820,381</u>

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 2: Summary of Significant Accounting Policies (Continued)

Fixed Assets

Fixed assets are recorded at historical cost and depreciated and amortized using the straight-line method over their estimated useful lives, which range from three to ten years. Leasehold improvements are amortized over the lesser of their useful lives or the lease terms. Upon sale or retirement, the cost and related accumulated depreciation and amortization are eliminated from their respective accounts, and the resulting gain or loss is included in results of operations. Repairs and maintenance charges, which do not increase the useful lives of the assets, are charged to operations as incurred.

Fixed assets consisted of the following at December 31:

	Estimated Useful Life (Years)	2010	2009
Lab and manufacturing equipment	3 – 10	\$ 3,095,195	\$ 2,936,239
Furniture and fixtures	3 – 7	285,003	300,372
Leasehold improvements	5	93,278	93,278
Vehicles	4 – 5	-	17,084
		<u>3,473,476</u>	<u>3,346,973</u>
Less: accumulated depreciation and amortization		<u>(2,754,315)</u>	<u>(2,507,334)</u>
		<u>\$ 719,161</u>	<u>\$ 839,639</u>

Depreciation and amortization expense of fixed assets for the years ended December 31, 2010 and 2009 was approximately \$309,000 and \$294,000, respectively, of which approximately \$235,000 and \$233,000, respectively, was included in cost of goods sold and approximately \$74,000 and \$61,000, respectively, was included in general and administrative costs in the accompanying consolidated statements of operations.

Intangible Assets

Intangible assets include patent and technology acquisition costs which are being amortized using the straight-line method over the estimated useful lives of the patents, determined to be twelve years. Capitalized patent and technology costs during the year ended December 31, 2010 were approximately \$181,000. No costs related to patents and technologies were capitalized during the year ended December 31, 2009. Amortization expense for the years ended December 31, 2010 and 2009 was approximately \$18,000 and \$14,000, respectively.

Intangible assets consisted of the following at December 31:

	2010	2009
Patents	\$ 893,347	\$ 712,394
Less: accumulated amortization	<u>(582,369)</u>	<u>(564,227)</u>
	<u>\$ 310,978</u>	<u>\$ 148,167</u>

Estimated annual amortization expense for the next five years is approximately \$29,300.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 2: Summary of Significant Accounting Policies (Continued)

Long-Lived Assets

The Company reviews its long-lived assets for impairment, including fixed assets that are held and used in its operations, whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If such an event or change in circumstances occurs, the Company will estimate the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the undiscounted future cash flows is less than the carrying amount of the related assets, the Company will recognize an impairment loss if the carrying value exceeds the fair value. Assets to be disposed of are reclassified as assets held for sale at the lower of their carrying amount or fair value less costs to sell. Write-downs to fair value less disposal costs are reported as a part of loss from operations.

The Company does not believe that there were any events or changes in circumstances which indicate that the carrying amounts of its long-lived assets may not be recoverable as of December 31, 2010 and 2009, respectively.

Accrued Expenses

Accrued expenses consisted of the following at December 31:

	<u>2010</u>	<u>2009</u>
Accrued bonuses, wages, and benefits	\$ 101,665	\$ 395,915
Accrued expenses relating to vendors and others	<u>316,331</u>	<u>317,248</u>
	<u>\$ 417,996</u>	<u>\$ 713,163</u>

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, inventory, accounts payable, accrued expenses, and accrued interest payable, approximate their fair values due to the short-term nature of these assets and liabilities. The note payable to stockholder and convertible subordinated debt approximate fair value based upon their short maturities and current rates available to the Company for loans with similar maturities.

Revenue Recognition

Revenue is recognized when (1) persuasive evidence of an arrangement exists; (2) services have been rendered or product has been delivered; (3) price to the customer is fixed and determinable; and (4) collection of the underlying receivable is reasonably assured. Revenues not meeting any of the aforementioned criteria are deferred.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 2: Summary of Significant Accounting Policies (Continued)

Revenue Recognition (Continued)

The Company recognizes revenue on product sales when title passes to the customer based upon the specified freight terms of the respective sale. Revenues are comprised of gross sales less provisions for expected customer returns, if any. Reserves for estimated returns and inventory credits are established by the Company, if necessary, concurrently with the recognition of revenue. The amounts of reserves are established based upon consideration of a variety of factors including estimates based on historical returns. Amounts billed to customers in sales transactions related to shipping and handling represent revenue earned for the goods provided and are included in net product related revenue in the accompanying consolidated statements of operations. Costs of shipping and handling are included in cost of goods sold.

The Company may be subjected to various product liability claims. Although there have been no claims to date against the Company, it is possible that future liability claims could have a material adverse effect on its consolidated financial position, consolidated results of operations and liquidity. The Company currently maintains product liability insurance with a deductible of \$5,000 per claim with an aggregate coverage on losses up to \$1,000,000.

Revenues derived from license agreements typically include multiple deliverables and milestone payments. The Company recognizes revenue based on the terms of each respective license agreement. Upfront and milestone payments received are recognized as revenue when products are delivered, services rendered ratably over the requisite service period and/or performance criteria are met. The Company did not enter into any license agreements during the year ended December 31, 2010. During the year ended December 31, 2009, the Company recognized \$10.0 million in license revenue from the Codexis License Agreement (*Note 3*).

The Company recognizes revenue from research funding under collaboration agreements when earned on a “proportional performance” basis as research hours are incurred. The Company performs services as specified in each respective agreement on a best-effort basis, and is reimbursed based on labor hours incurred on each contract. The Company initially defers revenue for any amounts billed or payments received in advance of the services being performed and recognizes revenue pursuant to the related pattern of performance, based on total labor hours incurred relative to total labor hours estimated under the contract.

The Company recognizes milestone payments when earned, as evidenced by written acknowledgement from the collaborator, provided that (i) the milestone event is substantive and its achievability was not reasonably assured at the inception of the agreement, (ii) the milestone represents the culmination of an earnings process, (iii) the milestone payment is non-refundable and (iv) the Company’s past research and development services, as well as its ongoing commitment to provide research and development services under the collaboration, are charged at fees that are comparable to the fees that the Company customarily charges for similar research and development services.

During the years ended December 31, 2010 and 2009, the Company recognized approximately \$1,011,000 and \$4,321,000, respectively, in R&D revenue. The Company recognized approximately \$3,333,000 in R & D revenue during the year ended December 31, 2009 related to the Abengoa R&D Agreement (*Note 3*).

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 2: Summary of Significant Accounting Policies (Continued)

Research and Development Costs

R&D costs related to both present and future products are charged to operations when incurred.

R&D costs incurred by type of project during the years ended December 31, 2010 and 2009, respectively, were as follows:

	<u>2010</u>	<u>2009</u>
Internal R&D	\$ 980,453	\$ 974,122
Collaborations with third parties	<u>260,057</u>	<u>236,913</u>
	<u>\$ 1,240,510</u>	<u>\$ 1,211,035</u>

R&D expense based upon type of cost incurred during the years ended December 31, 2010 and 2009, respectively, were as follows:

	<u>2010</u>	<u>2009</u>
Personnel related	\$ 909,000	\$ 916,495
Laboratory and supplies	29,267	16,459
Outside services	260,572	236,913
Facilities, overhead and other	<u>41,671</u>	<u>41,168</u>
	<u>\$ 1,240,510</u>	<u>\$ 1,211,035</u>

Foreign Currency Translation

The financial statements of the Company's foreign subsidiaries have been translated into U.S. dollars. Assets and liabilities of the Company's foreign subsidiaries are translated at period-end exchange rates, and revenues and expenses are translated at average rates prevailing during the period. Certain accounts receivable from customers are collected and certain accounts payable to vendors are payable in currencies other than the functional currencies of the Company and its subsidiaries. These amounts are adjusted to reflect period-end exchange rates.

Share-based Compensation

The Company values its options on the date of grant using the Black-Scholes valuation model. Any options with modified terms are re-valued using the Black-Scholes valuation model based on the new terms at the date the modifications are approved by the compensation committee (the "Compensation Committee") of the Company's Board of Directors (the "Board"). Any incremental cost resulting from the revised valuations is charged to results of operations, and the remaining unvested portions of the options are amortized over the modified remaining vesting period.

The Company accounts for equity instruments issued to non-employees by calculating the fair value of the equity instrument using the Black-Scholes valuation model at each reporting period with charges amortized to the results of operations over the instrument's vesting period.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 2: Summary of Significant Accounting Policies (Continued)

Income Taxes

The Company accounts for income taxes using the liability method. Under this method, deferred tax assets and liabilities are determined based on the difference between the consolidated financial statements and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. A deferred tax asset valuation allowance is established if, in management's opinion, it is more likely than not that all or a portion of the Company's deferred tax assets will not be realized.

Effective January 1, 2009, the Financial Accounting Standards Board ("FASB") issued guidance that addresses accounting for uncertainty in income taxes which requires that a position taken or expected to be taken in a tax return be recognized in the consolidated financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. No such interest or penalties were recognized during the years ended December 31, 2010 and 2009. The adoption of this guidance did not have a significant impact on the Company's consolidated financial statements.

Net Income (Loss) Per Share

Basic income (loss) per share excludes any dilution. It is based upon the weighted average number of common shares outstanding during the period. Diluted income (loss) per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. As of December 31, 2010 and 2009, 3,169,602 and 75,000 shares of common stock, respectively, underlying stock options and warrants were not included in computing diluted earnings per share because their effects would be anti-dilutive.

Recent Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Update ("ASU") 2009-13, "Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements" ("Update 2009-13"). Update 2009-13 applies to multiple-deliverable revenue arrangements that are currently within the scope of FASB Accounting Standards Codification ("ASC") Subtopic 605-25 (previously included in Emerging Issues Task Force Issue no. 00-21, "Revenue Arrangements with Multiple Deliverables"). Update 2009-13 provides principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated, and the consideration allocated. It also requires an entity to allocate revenue in an arrangement using estimated selling prices of deliverables if a vendor does not have vendor-specific objective evidence or third-party evidence of selling price. The guidance eliminates the use of the residual method, requires entities to allocate revenue using the relative-selling-price method, and significantly expands the disclosure requirements for multiple-deliverable revenue arrangements. Update 2009-13 is effective on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently assessing the impact of Update 2009-13 on its future consolidated financial statements.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 2: Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

In April 2010, FASB issued ASU No. 2010-17, "Revenue Recognition - Milestone Method (Topic 605): Milestone Method of Revenue Recognition" (codified within ASC 605 - Revenue Recognition). ASU 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. ASU 2010-17 is effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2010 with early adoption permitted. The adoption of ASU 2010-17 did not have a material impact on the Company's consolidated financial statements.

Reclassifications

Certain amounts in the prior year's consolidated financial statements have been reclassified to conform to the current year's presentation.

Note 3: Significant Agreements

Abengoa Agreements

On October 26, 2006, the Company entered into a securities purchase agreement (the "Abengoa Securities Purchase Agreement") and a non-exclusive R&D agreement (the "Abengoa R&D Agreement") with Abengoa Bioenergy R&D, Inc. (now known as Abengoa Bioenergy New Technologies, Inc., and hereinafter referred to as, "Abengoa") (the Abengoa Securities Purchase Agreement and the Abengoa R&D Agreement shall hereinafter collectively be referred to as, the "Abengoa Agreements"). Abengoa is a subsidiary of Abengoa S.A. which is one of the largest ethanol producers and alternative energy companies in the world.

Under the Abengoa Securities Purchase Agreement, the Company issued 2,136,752 shares of the Company's common stock to Abengoa for an aggregate purchase price of \$10,000,000 (*Note 5*). This strategic investment in the Company was to fund the Company's R&D activities in the field of cellulosic ethanol production as provided in the Abengoa R&D Agreement.

Under the Abengoa Agreements, the Company agreed to spend a minimum of \$10,000,000 over a three-year period to conduct R&D activities for Abengoa and other collaboration partners. Under the Abengoa R&D Agreement, the Company sought to apply the C1 Platform Technology to the development and production of cost-effective enzyme mixtures and related processing and manufacturing technologies for commercial application in Abengoa's bioethanol (cellulosic ethanol) production process.

As the Company did not enter into a transaction involving the sale of its securities totaling at least \$20,000,000 in gross proceeds within six months following the date of closing of the Abengoa Securities Purchase Agreement, on May 14, 2007, the Company granted Abengoa a warrant to purchase 427,351 shares of the Company's common stock at an exercise price of \$5.85 per share which expired on May 13, 2010. At December 31, 2010 and 2009, respectively, none of these warrants had been exercised (*Note 7*).

On February 18, 2009, the Company and Abengoa mutually agreed to terminate the Abengoa R&D Agreement, entered into a non-exclusive license agreement (the "Abengoa License Agreement") and settled and released all claims between the parties in the ABNT Litigation (collectively, the "Abengoa Events") (*Note 5*). Under the Abengoa License Agreement, the Company granted Abengoa the right to

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 3: Significant Agreements (Continued)

Abengoa Agreements (Continued)

use certain patent rights and know-how owned by the Company in certain territories relating to the C1 Platform Technology for the large-scale production of enzymes for use in manufacturing biofuels (including cellulosic ethanol and butanol), power and/or chemicals. The Abengoa License Agreement provides for facility fees and royalties to be paid to Dyadic upon the commercialization of biofuels and other products which utilize the Company's materials and technologies. The Abengoa Events did not become effective until May 12, 2009, when the Company completed the delivery of certain materials to Abengoa which was a condition precedent to releasing from escrow the Abengoa License Agreement and a settlement agreement between the parties which made the Abengoa Events effective. The Company did not recognize any research and development revenue from the Abengoa Agreement during the year ended December 31, 2010. For the year ended December 31, 2009, the Company recognized research and development revenue of approximately \$3,333,000.

Codexis License Agreement

On November 14, 2008, the Company entered into a non-exclusive license agreement (the "Codexis License Agreement") with Codexis, Inc. ("Codexis") which granted to Codexis the non-exclusive right to use Dyadic's C1 Platform Technology for the development, production and sale of enzymes in the fields of biofuels, certain pharmaceuticals, chemicals, air treatment, water treatment and the conversion of biomass into fermentable sugars for use in certain non-fuel products. Codexis also obtained access to specified materials of Dyadic relating to the C1 Platform Technology. The license is sublicenseable to Equilon Enterprises, LLC dba Shell Oil Products US in the field of biofuels, and sublicenseable to third parties in the fields of certain pharmaceuticals, chemicals, air treatment, water treatment and the conversion of biomass into fermentable sugars for non-fuel products. Dyadic and Codexis each agreed that neither it nor its affiliates or sublicensees will assert any claim of infringement of any patent covering improvements to the Dyadic materials that were made by that party or its affiliates or sublicensees against the other party, or its affiliates, sublicensees, successors, distributors, or customers.

The Codexis License Agreement provides for Codexis to pay Dyadic certain license issuance fees, milestone payments, and fees based on the volume of products sold or manufactured using the C1 Platform Technology. In accordance with the Codexis License Agreement, Codexis paid Dyadic an upfront payment of \$10 million (the "Codexis Upfront Payment") during the year ended December 31, 2009 after Dyadic satisfied certain performance criteria. The entire Codexis Upfront Payment is non-refundable as a result of the Company meeting certain performance criteria on April 15, 2009. The Company was also obligated to provide Codexis with information and technical assistance including, but not limited to, access to two full-time equivalent scientists valued at \$500,000, during the first 12 months of the Codexis License Agreement. The Company did not recognize any license revenue from the Codexis License Agreement during the year ended December 31, 2010. For the year ended December 31, 2009, the Company recognized license revenue from Codexis of \$10,000,000.

Codexis has the right to terminate the license agreement at will upon notice now that the license issuance fees have been paid. Either party has the right to terminate the license agreement for a material breach of the other party that is uncured within a period of time after notice. Dyadic has the right to terminate Codexis's licenses under the Codexis License Agreement if Codexis challenges the validity of any of the patents licensed under the Codexis License Agreement. Codexis's licenses, and access to Dyadic's materials under the Codexis License Agreement will terminate as a result of any termination of the Codexis License Agreement other than due to Dyadic's material breach.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 3: Significant Agreements (Continued)

Codexis License Agreement (Continued)

Contemporaneously with entering into the Codexis License Agreement, the Company also entered into a Non-Disturbance Agreement (the “Non-Disturbance Agreement”) with the Mark A. Emalfarb Trust under agreement dated October 1, 1987, as amended (the “MAE Trust”), the Francisco Trust under agreement dated February 29, 1996 (the “Francisco Trust”), and Mark A. Emalfarb, individually (collectively, the “Secured Parties”). Among other things, the Non-Disturbance Agreement provides that the Secured Parties shall not take any action against the Company or its affiliates which could diminish, disturb or interfere with (i) the Company’s rights to the intellectual property or other materials licensed to Codexis under the Codexis License Agreement or (ii) Codexis’s rights to the licensed intellectual property and other materials under the Codexis License Agreement. The MAE Trust is a stockholder of the Company whose trustee and beneficiary is the Company’s President, Chief Executive Officer and Chairman of the Board, Mark A. Emalfarb. The Francisco Trust is an entity created for the primary benefit of the wife and children of Mark A. Emalfarb.

Note 4: Notes Payable

Note Payable to Stockholder

On May 29, 2003, Dyadic-Florida obtained a \$3.0 million revolving loan from the MAE Trust and a group of other shareholders of Dyadic-Florida as evidenced by a revolving note (as amended, the “Revolving Note”) from Dyadic-Florida which was due on January 2, 2004. The Revolving Note was secured by certain assets of Dyadic-Florida pursuant to a Security Agreement dated May 7, 2000, as amended, and a Security Agreement dated as of May 29, 2003, as amended, between Dyadic-Florida and the MAE Trust (collectively, the “Security Agreements”).

In consideration for the Revolving Note, the MAE Trust and a group of other shareholders of Dyadic-Florida were also collectively granted warrants to purchase up to 1.5 million shares of Dyadic-Florida’s common stock at the lesser of \$4.50 per share or the conversion price of Dyadic-Florida’s Series A Preferred Stock, expiring ten years from the date of grant (the “Note Warrants”). In August 2004, the exercise price of the Note Warrants was reduced to \$3.33 and the maturity date of the Revolving Note was extended to January 1, 2007. As a result, approximately \$343,000, representing the incremental fair value of the modified warrant as compared to the fair value of the original warrant immediately before the modification, was amortized to interest expense through the new maturity date. The maturity date of the Revolving Note was subsequently extended to January 1, 2009. The remaining unamortized portion of approximately \$26,000 of the beneficial conversion feature was amortized through this new maturity date. There was no amortization during the years ended December 31, 2010 and 2009.

On October 3, 2007, the Company received a written notice of default from the MAE Trust based on numerous events reported in the Company’s previously issued press releases and filings with the SEC which the MAE Trust alleged to be events of default under the Revolving Note and Security Agreement and caused the MAE Trust, among other alleged defaults, to deem itself “insecure”. On January 2, 2008, the Company received a letter from the MAE Trust declaring the Revolving Note to be in default and demanding immediate payment of the Revolving Note’s principal, all interest accrued from October 1, 2007 forward, and legal fees incurred by the MAE Trust.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 4: Notes Payable (Continued)

Note Payable to Stockholder (Continued)

On November 14, 2008, the Company entered into an Amended & Restated Note (the "Note") for the benefit of the MAE Trust in the principal amount of \$2,424,941, which amended and replaced the Revolving Note. Under the Note, the Company was obligated to pay interest to the MAE Trust from and after January 1, 2008 at a rate of 14% per annum and also make certain scheduled payments pursuant to the terms therein. Deferred and unpaid interest under the Revolving Note or under the Note bears interest at a rate of 14% per annum.

In connection with the Note, on November 14, 2008, the Company also entered into a Loan and Security Agreement (the "Loan Agreement") with the Secured Parties which was in addition to the prior Security Agreements. Among other things, the Loan Agreement and Security Agreements secure the borrowings under the Note with all of the assets of the Company. The Loan Agreement also provides for the re-pricing of certain warrants to purchase the Company's common stock previously issued to the MAE Trust and other loan participants in connection with the Revolving Note (*Note 7*).

On November 14, 2008, Dyadic-Florida entered into a Collateral Assignment of Inventions and Patents and Patent Applications, a Collateral Assignment of Trademarks and Account Control Agreements (collectively, the "Collateral Assignment Agreements"), in favor of the Secured Parties. Among other things, under the Collateral Assignment Agreements, Dyadic-Florida grants, transfers and assigns to the Secured Parties all right title and interest in the patents identified by the Codexis License Agreement for purposes of securing any and all obligations owed to the Secured Parties pursuant to the terms of the Loan Agreement.

The Note is repayable by the Company as follows: (i) \$1.0 million on or before the first to occur of December 15, 2008, or the date which Dyadic-Florida receives or is scheduled to receive the first payment under the Codexis License Agreement (*Note 3*); and 50% or such lesser percentage as the MAE Trust is willing to accept of each additional payment received by Dyadic-Florida under the Codexis License Agreement. The Secured Parties agreed that the Note is subject to the limitations of the Non-Disturbance Agreement (*Note 3*). On January 12, 2009, after receiving the first payment from Codexis under the Codexis License Agreement, pursuant to the terms of the Note, the Company repaid \$1,000,000 of principal of the Note. To date, the MAE Trust continues to receive interest payments under the Note but has not requested any further repayment of the Note although it is entitled to demand that all unpaid principal and accrued interest on the Note become immediately due and payable. As of January 1, 2010, the MAE Trust and the Company agreed to reduce the interest rate on the outstanding principal balance of the Note from 14% to 9.5% per annum.

At December 31, 2010 and 2009, the principal amount outstanding under the Note was approximately \$1,424,000 with accrued interest payable to stockholder of approximately \$34,000 and \$60,000, respectively. Interest expense on the Note was approximately \$135,000 and \$213,000, respectively, for the years ended December 31, 2010 and 2009.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 4: Notes Payable (Continued)

Convertible Subordinated Debt

On August 23, 2010, the Company completed the private placement of \$4,000,000 aggregate principal of convertible subordinated secured promissory notes (the "Notes") with a number of investors. The Notes pay interest quarterly at 8% per annum and include a convertibility feature at the holder's option after January 1, 2011. The Notes are convertible into unregistered shares of the Company's common stock at a price of \$1.82 per share, which represents 120% of the average closing price of the Company's common stock for the 30-day period preceding August 23, 2010. The Company will not affect any conversion of the Notes, to the extent that after giving effect to such conversion, any holder would beneficially own in excess of 4.9% of the Company's outstanding common stock (the "Beneficial Ownership Limitation"). The Beneficial Ownership Limitation may be waived by the holder upon not less than 61 days prior notice. The Notes are subordinated to the note payable to stockholder, collateralized by the assets of the Company and mature on January 1, 2013.

Approximately \$1,300,000 of the Notes are held by four related party interests which include members of management and the Board, as well as another related party. Interest expense on the convertible subordinated debt was approximately \$112,000 for the year ended December 31, 2010.

Note 5: Commitments and Contingencies

Leases

Jupiter, Florida Headquarters

The Company's corporate headquarters are located in Jupiter, Florida. The Company occupies approximately 4,872 square feet with a monthly rental rate and common area maintenance charges of approximately \$8,400. The lease expires on December 31, 2013.

On May 18, 2009, the Company issued 50,000 shares of the Company's common stock with a value of \$5,000 based on the then current price of the Company's common stock to the landlord of the Company's headquarters in Jupiter, Florida in exchange for certain rent and occupancy concessions under an agreement entered into on November 6, 2008 (*Note 6*).

Jupiter, Florida Laboratory

The Company leases a laboratory facility in Jupiter, Florida which consists of approximately 3,500 square feet with a monthly rental rate of approximately \$4,000. The lease expires on July 30, 2013.

Greensboro, North Carolina Laboratory

The Company leases a laboratory facility and a storage building in Greensboro, North Carolina which consists of approximately 3,150 square feet with a monthly rental rate of approximately \$2,100. The lease is currently on a month-to-month basis.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 5: Commitments and Contingencies (Continued)

Leases (Continued)

The Netherlands Office and Laboratory

Dyadic NL leases office and laboratory space in Wageningen, The Netherlands, which consists of approximately 5,285 square feet with a monthly rental rate of approximately \$16,000. The lease expires on August 31, 2012 and contains automatic one-year renewals that require a one-year notice of non-renewal.

Poland Office and Warehouse

Dyadic Poland closed its office and warehouse facility effective April 30, 2010.

Future minimum lease commitments due for facilities and equipment leases under non-cancellable operating leases at December 31, 2010 are as follows:

2011	\$	281,600
2012		238,300
2013		<u>129,500</u>
	\$	<u>649,400</u>

Rent expense under all operating leases for the years ended December 31, 2010 and 2009 totaled approximately \$352,000 and \$354,000, respectively, of which approximately \$43,000 for each year is included in cost of goods sold and approximately \$309,000 and \$311,000 is included in general and administrative expenses, respectively, in the accompanying consolidated statements of operations.

Manufacturing Commitment

The Company manufactures all of its enzymes with a third party manufacturer which the Company believes is sufficient to meet its current needs. In order to grow its business, the Company will require additional manufacturing capacity. There is no assurance that the Company will be able to maintain its current manufacturing capacity or be able to secure additional capacity on acceptable terms and conditions as and when needed by the Company. Any interruption in or failure to secure such manufacturing capacity could have a material adverse effect on the Company's results of operations.

Litigation, Claims and Assessments

Pending Actions

Professional Liability Lawsuit

On March 26, 2009, the Company filed a complaint in the Circuit Court of the 15th Judicial Circuit in and for Palm Beach County, Florida against Ernst & Young LLP and Ernst & Young-Hong Kong, L.P., alleging professional negligence/malpractice, breach of fiduciary duty and constructive fraud in connection with the accounting, advisory, auditing, consulting, financial and transactional services they provided to the Company.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 5: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Pending Actions (Continued)

On April 14, 2009, the Company amended the complaint (the “Amended Complaint”) by naming as additional defendants the Company’s former outside legal counsel consisting of the law firms of Greenberg Traurig, LLP, Greenberg Traurig, P.A. (collectively, “Greenberg Traurig”), Jenkins & Gilchrist, P.C. and Bilzin Sumberg Baena Price & Axelrod LLP (“Bilzin Sumberg”) as well as attorney Robert I. Schwimmer who previously represented the Company while an attorney at Jenkins & Gilchrist and later at Greenberg Traurig. The Company also named as defendants the law firm of Moscowitz & Moscowitz, P.A. and its attorneys, Norman A. Moscowitz and Jane W. Moscowitz (collectively, the “Moscowitz Defendants”) who conducted the investigation and authored the investigative report requested by the Company’s Audit Committee following the discovery of alleged improprieties at the Company’s Asian subsidiaries. The claims against the Company’s former outside legal counsel are for breach of fiduciary duty and professional negligence. In addition to these claims, the Amended Complaint contains a claim of civil conspiracy against Ernst & Young LLP, Greenberg Traurig and Mr. Schwimmer.

On September 22, 2009, the Court granted Ernst & Young LLP’s motion to compel arbitration and to stay all Circuit Court proceedings between Ernst & Young LLP and the Company. Pursuant to an Agreed Order in August 2010, Ernst & Young-Hong Kong L.P. joined the arbitration and the Circuit Court action against it was stayed. A final hearing before the arbitration panel is scheduled for the three week period commencing on May 9, 2011.

The Company and the Defendants in the Circuit Court proceeding are continuing to engage in written discovery and oral depositions which are expected to continue throughout the foreseeable future.

Mark A. Emalfarb Arbitration

On September 25, 2007, Mark A. Emalfarb commenced an arbitration proceeding (the “Emalfarb Arbitration”) against the Company before the American Arbitration Association seeking monetary damages resulting from his termination for cause pursuant to his employment agreement dated as of April 1, 2001 (as amended, the “Employment Agreement”). This arbitration action asserts, among other things, that “cause” as defined in the Employment Agreement, did not exist and that his reputation had been damaged by the Company. On October 22, 2007, the Company filed an answering statement and motion to dismiss the arbitration. On April 1, 2008, Mr. Emalfarb responded to Dyadic’s answering statement and motion to dismiss and filed a Supplemental Demand for Arbitration against Dyadic asserting various counts and demanding full recompense from the Company for damages relating to such termination. The Company’s primary and excess insurance carriers denied coverage for the Emalfarb Arbitration based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company’s insurance policies. In consideration for the contribution by the insurance carriers to the resolution of the Class Action Litigation (as defined below), all pending claims with such insurance carriers with respect to the Emalfarb Arbitration were released. This arbitration is currently stayed indefinitely but may be re-initiated by Mr. Emalfarb at any time.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 5: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Resolved Actions

SEC Action

In April 2007, the SEC initiated an informal inquiry of the Company (the "SEC Action") based on the Company's voluntary disclosures of alleged improprieties at its Asian subsidiaries which were abandoned in May 2007. The Company's primary and excess insurance carriers denied coverage for the SEC Action based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies. In consideration for the contribution by the insurance carriers to the resolution of the Class Action Litigation (as defined below), all pending claims with such insurance carriers with respect to the SEC Action were released. The Company submitted an Offer of Settlement to the SEC which was accepted on June 4, 2009. The Company's Offer of Settlement included the issuance of a cease-and-desist order (the "Order") by the SEC against the Company which directed the Company to cease and desist from committing or causing any violations of certain clauses of the Securities and Exchange Act of 1934, as amended. The Order did not impose any monetary or other penalty on the Company, its officers or directors and the Company did not admit or deny any of the findings contained in the Order.

Class Action Stockholder Lawsuit

On October 12, 2007, Michael Miller, a stockholder of the Company, filed the first class action in the U.S. District Court for the Southern District of Florida and others were subsequently filed (the "Class Action Litigation"). On December 13, 2007, the Court consolidated the various actions and appointed Capital Max, Inc. as lead plaintiff ("Capital Max"). On June 27, 2008, Capital Max filed an Amended and Consolidated Class Action Complaint on behalf of all persons who purchased or acquired the Company's securities during the period of October 29, 2004 through April 23, 2007 (the "Class Period") against the Company and the following current and former officers and directors of the Company: Richard J. Berman, Mark A. Emalfarb, Rufus Gardner, Wayne Moor, Harry Z. Rosengart and Stephen J. Warner (collectively, the "Defendants"). Capital Max alleged violations of Section 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78j(b) and 78t(a) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, based on the alleged failure of the Defendants to disclose in statements to the SEC and to the investing public actual occurrences and risk of financial and operational improprieties by the Company's Asian subsidiaries during the Class Period. In its Order of November 25, 2008, the Court dismissed the Amended Consolidated Class Action Complaint as to Defendants Richard J. Berman, Harry Z. Rosengart, Stephen J. Warner and Wayne Moor without prejudice. The Court denied the motions to dismiss filed by Defendants Mark A. Emalfarb and the Company.

On December 22, 2008, Capital Max filed the Second Amended and Consolidated Class Action complaint (the "Second Amended Complaint"). In January 2009, Defendants Gardner, Berman, Rosengart, Warner and Moor filed motions to dismiss the Second Amended Complaint. On September 29, 2009, the Court dismissed the Section 10(b) count of the Second Amended Complaint with prejudice with respect to Messrs. Berman, Rosengart and Warner, leaving Messrs. Emalfarb, Gardner and Moor as well as the Company to defend against such claim. The Court denied the motions to dismiss by Messrs. Berman, Rosengart, Warner, Gardner and Moor with respect to the Section 20(a) count, leaving those

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 5: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Resolved Actions (Continued)

Defendants along with Mr. Emalfarb and the Company to defend against such claim. The Company's primary and excess insurance carriers denied coverage for the Class Action Litigation based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies. In consideration for the contribution by the insurance carriers to the resolution of the Class Action Litigation, all pending claims with such insurance carriers with respect to the Class Action Litigation were released.

On April 16, 2010, the parties to the Class Action Litigation filed a Stipulation of Settlement with the Court which provided for payment to the alleged class of \$4.8 million of which \$2.8 million was funded by the Company and \$2.0 million was funded by its insurance carriers. The Stipulation of Settlement was preliminarily approved by the Court on April 20, 2010 and finally approved on July 27, 2010 which resulted in the dismissal of the Class Action Litigation with prejudice.

Abengoa Litigation

On November 7, 2007, Abengoa filed a complaint in the Circuit Court of the 15th Judicial Circuit in and for Palm Beach County, Florida against the Company and Mark A. Emalfarb, a director of the Company (the "ABNT Litigation"). The ABNT Litigation related to the Abengoa Securities Purchase Agreement (*Note 3*) pursuant to which Abengoa purchased 2,136,752 shares of the Company's common stock for an aggregate purchase price of \$10 million in November 2006. The complaint sought indemnification under the Abengoa Securities Purchase Agreement, monetary damages of at least \$10 million, and the costs and expenses incurred in prosecuting the action, among other things. The Company's primary and excess insurance carriers denied coverage for the ABNT Litigation based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies. In consideration for the contributions by the insurance carriers to the resolution of the Class Action Litigation described above, all pending claims with such insurance carriers with respect to the ABNT litigation were released. The ABNT Litigation was settled and voluntarily dismissed with prejudice on May 13, 2009.

Indemnification Demands

In August 2008, the Company received the first of several written demands from legal counsel representing the Company's former directors, Wayne Moor, Harry Z. Rosengart and Richard J. Berman, for advancement and indemnification of their legal expenses relating to the Class Action Litigation and the SEC Action. The Company's primary and excess insurance carriers denied coverage for the Class Action Litigation and the SEC Action based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies. In consideration for the contributions by the insurance carriers to the resolution of the Class Action Litigation described above, all pending claims with such insurance carriers with respect to the Class Action Litigation and the SEC Action were released. On April 23, 2010, the Company paid the remaining legal fees and costs of Messrs. Moor, Rosengart and Berman of approximately \$135,000, agreed to pay their reasonable attorneys' fees and costs to finalize the settlement of the Class Action Litigation up to a maximum of \$25,000, and executed mutual releases with them covering the matters for which Messrs. Moor, Rosengart and Berman and the Company released the insurance carriers.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 5: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Resolved Actions (Continued)

Excess Insurance Carrier Litigation

On November 3, 2008, the Company's excess insurance carrier filed a declaratory action in the Circuit Court of the 15th Judicial Circuit in and for Palm Beach County, Florida against the Defendants and Capital Max (collectively, the "Insurance Defendants") seeking a declaration that the carrier had no obligation to provide coverage for the Class Action Litigation. The coverage at issue was an excess policy to the Company that covered the time period from October 27, 2006 to October 27, 2007. The excess carrier denied coverage for the Class Action Litigation based on its interpretation of exclusions contained in the Company's insurance policy. On July 29, 2009, the Court granted the Insurance Defendants' motion to stay the action indefinitely. As a result of the final approval of the resolution of the Class Action Litigation by the Court on July 27, 2010, this action was dismissed with prejudice on November 4, 2010.

Other

In addition to the matters noted above, from time to time, the Company is subject to legal proceedings, asserted claims and investigations in the ordinary course of business, including commercial claims, employment and other matters, which management considers immaterial, individually and in the aggregate. The Company makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Litigation is inherently unpredictable and costly. While the Company believes that it has valid defenses with respect to the legal matters pending against it, protracted litigation and/or an unfavorable resolution of one or more of such proceedings, claims or investigations against the Company could have a material adverse effect on the Company's consolidated financial position, cash flows or results of operations.

Note 6: Capital Structure

Since 2001, the Company has raised approximately \$70 million in equity capital including, but not limited to, the following transactions:

Issuances of Common Stock

The Company issued 252,375 shares of its common stock on various dates during 2010 for stock option exercises for total cash proceeds of approximately \$35,000 (*Note 7*).

The Company issued 241,750 shares of its common stock on various dates during 2010 for warrant exercises for total cash proceeds of approximately \$17,000 (*Note 7*).

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 6: Capital Structure (Continued)

Landlord Issuance

On May 18, 2009, the Company issued 50,000 shares of the Company's common stock to the landlord of the Company's headquarters in Jupiter, Florida in exchange for certain rent and occupancy concessions under an agreement entered into on November 6, 2008 with a value of \$5,000 based on the then current price of the Company's common stock.

Financial Advisor

On September 30, 2009, the Company entered into a Financial Advisory Agreement (the "Advisory Agreement") with a financial advisory firm (the "Advisor") and in consideration for services to be rendered thereunder, agreed to issue 5,000 shares of the Company's common stock per month over a period of six months for a total of 30,000 shares of common stock. The Advisory Agreement had a term of six months with automatic one-month renewals unless either party provides the other with ten days written notice of its intention not to renew.

On March 15, 2010, the Company notified the Financial Advisor of its intention not to renew the Advisory Agreement which terminated on March 30, 2010 in accordance with its terms.

Note 7: Share-Based Compensation

Issuances of Common Stock

During the years ended December 31, 2010 and 2009, the Company received an aggregate of \$51,281 and \$107,204, respectively, in proceeds from the exercises of the following instruments: (i) warrants to purchase an aggregate of 112,500 and 565,434 shares of its common stock, respectively, at exercise prices of \$0.15 and \$0.16 per share, and (ii) stock options to purchase an aggregate of 222,375 and 137,000 shares of its common stock, respectively, granted under the Equity Compensation Plans (as defined below) with exercise prices of \$0.15 and \$0.23 per share. Included in the December 31, 2009 cash proceeds were 159,250 shares of common stock exercised but not issued until 2010. These shares of common stock were included in stock to be issued as of December 31, 2009.

Warrants

At December 31, 2010 and 2009, 1,145,750 and 2,343,333 shares of common stock have been reserved for issuance under outstanding warrants. All of the warrants are fully vested and expire on May 29, 2013. Information concerning the Company's warrant activity is as follows:

	<u>2010</u>		<u>2009</u>	
	<u>Warrants</u>	<u>Weighted-Average Exercise Price</u>	<u>Warrants</u>	<u>Weighted-Average Exercise Price</u>
Outstanding at the beginning of the year	2,343,333	\$ 2.89	6,775,227	\$ 4.15
Retired	(1,085,083)	6.06	(3,866,460)	5.50
Exercised	(112,500)	0.15	(565,434)	0.15
Outstanding at the end of the year	<u>1,114,750</u>	\$ 0.15	<u>2,343,333</u>	\$ 2.89

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 7: Share-Based Compensation (Continued)

Repricing of Specified Warrants

On November 12, 2008, the Board approved the resetting of the exercise prices of certain warrants issued prior to November 12, 2008, that were not exercised as of such date, to the Company's officers, directors, advisors or consultants or any other person who was then employed by or serving the Company or its subsidiaries, or as otherwise specified by the Company. The reset exercise price was based upon a specific formula which resulted in a reset price of \$0.15 per share or \$0.16 per share with respect to the warrants previously granted to the MAE Trust or the Company's President and Chief Executive Officer, Mark A. Emalfarb.

Description of Equity Plans

The Company maintains the Dyadic International, Inc. 2001 Equity Compensation Plan (as amended and restated, the "2001 Equity Plan") and the Dyadic International, Inc. 2006 Stock Option Plan, as amended (the "2006 Option Plan") (the 2001 Equity Plan and the 2006 Option Plan are hereinafter collectively referred to as the "Equity Compensation Plans"). All options granted under the Equity Compensation Plans are service-based and typically vest over a four year period. As of December 31, 2010, there were 918,813 service-based options that were exercisable.

2001 Equity Plan

The 2001 Equity Plan was adopted by the Company in May 2001 and amended and restated as of January 1, 2005. Under the 2001 Equity Plan, 4,478,475 shares of common stock are currently reserved for issuance. Eligible participants under the 2001 Equity Plan include all employees and Key Advisors (as defined in the 2001 Equity Plan) of the Company as well as its Board members. Awards under the 2001 Equity Plan may consist of grants of incentive stock options and nonqualified stock options to purchase the Company's common stock as well as issuances of common stock. Such shares, if issued, may be subject to restrictions, as disclosed in the 2001 Equity Plan. In addition to stock options and stock grants, the 2001 Equity Plan allows for the issuance of Performance Units (as defined in the 2001 Equity Plan) to an employee or Key Advisor. Each Performance Unit represents the right to receive an amount in cash or in the Company's common stock, as determined by a committee of the Company's Board, based on the value of the Performance Unit, if established performance goals are met. As of December 31, 2010, there were no stock options outstanding and 3,962,225 available for grant under the 2001 Equity Plan. The terms of the stock options outstanding under the 2001 Equity Plan range between five and ten years.

2006 Stock Option Plan

The 2006 Option Plan was adopted by the Company in April 2006 and amended on December 9, 2009. The purpose of the 2006 Option Plan is to retain and attract key management, employees, non-employee directors and consultants by providing those persons with a proprietary interest in the Company. The Compensation Committee of the Board administers the 2006 Option Plan and may grant incentive stock options or nonqualified stock options that do not comply with Section 422 of the Internal Revenue Code. Under the 2006 Option Plan, 4,700,000 shares of common stock have been reserved for issuance. As of December 31, 2010, there were 3,097,375 stock options outstanding and 1,430,500 available for grant under the 2006 Option Plan. The term of the stock options outstanding under the 2006 Option Plan is ten years.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 7: Share-Based Compensation (Continued)

Valuation of Stock Options

Share-based compensation related to stock options is determined using the single option approach under the Black-Scholes valuation model. The fair value of options is amortized to expense over the vesting periods of the underlying options, generally four or five years.

The fair value of stock option awards for the years ended December 31, 2010 and 2009 was estimated on the date of grant using the assumptions in the following table. The expected volatility in this model is based on the historical volatility of the Company's stock. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time awards are granted, based on maturities which approximate the expected life of the stock options. The expected life of the stock options granted is estimated using the historical exercise behavior of employees. The expected dividend rate takes into account the absence of any historical payments and the Board's intention to retain all earnings, if any, for future operations and expansion.

Assumptions used in the Black-Scholes valuation model for stock options granted were as follows:

	<u>Year Ended</u> <u>December 31, 2010</u>	<u>Year Ended</u> <u>December 31, 2009</u>
Average Risk-Free Interest Rate	3.57% - 3.87%	2.98% - 3.56%
Dividend Yield	0.00%	0.00%
Average Volatility Factor	126.97 - 127.70%	90.48% - 128.91%
Average Option Life	10 years	10 years

Repricing of Specified Stock Options

On November 12, 2008, the Board approved the resetting of the exercise prices of certain stock options issued prior to November 12, 2008, that were not exercised as of such date, to the Company's officers, directors, advisors or consultants or any other person who was then employed by or served the Company or its subsidiaries, or as otherwise specified by the Company. The reset exercise price was based upon a specific formula which resulted in a reset price of \$0.15 per share, which estimated the fair market value of the Company's common stock on the modification date, or \$0.16 per share with respect to the stock options previously granted to the MAE Trust or the Company's President and Chief Executive Officer, Mark A. Emalfarb. The fair market value for such options, calculated using an average risk-free interest rate of 1.55% and an average volatility factor of 70.25%, was \$0.11 per share.

Forfeiture Rate for Options

The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods on a cumulative basis in the period the estimated forfeiture rate changes for all share-based awards.

During the years ended December 31, 2010 and 2009, the Company terminated four and two employees, respectively. A cumulative adjustment of \$38,261 and \$3,629 was recorded as a reduction to non-cash share-based compensation expense in the Company's consolidated results of operations for the years ended December 31, 2010 and 2009, respectively.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 7: Share-Based Compensation (Continued)

Forfeiture Rate for Options (Continued)

The Company considered its historical experience of stock option forfeitures as the basis to arrive at its estimated average stock option forfeiture rate of 5% per year for remaining stock options for the years ended December 31, 2010 and 2009 for all stock option awards.

Non-cash Share-based Compensation Expense

The Company recognized non-cash share-based compensation expense/recovery for its share-based awards of approximately \$888,000 and \$118,000 for the years ended December 31, 2010 and 2009, respectively. These charges had no impact on the Company's reported cash flows.

Total non-cash share-based compensation expense was allocated among the following expense categories:

	Year Ended December 31,	
	2010	2009
General and administrative	\$ 699,066	\$ 91,374
Research and development	37,245	8,659
Cost of goods sold	73,595	9,346
Sales and marketing	78,241	8,724
	\$ 888,147	\$ 118,103

Equity Compensation Plans Awards Activity

Information with respect to the Company's Equity Compensation Plans is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2008	1,943,500	\$ 0.24
Granted	704,000	0.41
Exercised	(137,000)	0.15
Expired	(47,500)	0.15
Cancelled	(45,500)	0.15
	2,417,500	0.30
Outstanding at December 31, 2009	2,417,500	0.30
Granted	990,000	2.07
Exercised	(222,375)	0.16
Expired	(45,750)	0.15
Cancelled	(42,000)	0.35
	3,097,375	\$ 0.91
Outstanding at December 31, 2010	3,097,375	\$ 0.91
Exercisable at December 31, 2010	918,813	\$ 0.39

The weighted average grant date fair values of stock options granted during the years ended December 31, 2010 and 2009 were \$2.13 and \$0.37 per share, respectively.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 7: Share-Based Compensation (Continued)

Equity Compensation Plans Awards Activity (Continued)

Cash received from stock option exercises during the years ended December 31, 2010 and 2009 was \$34,629 and \$20,550, respectively. The Company has a net operating loss carryforward as of December 31, 2010 and, therefore, no excess tax benefits for tax deductions related to the stock options were recognized.

A further detail of the stock options outstanding as of December 31, 2010 is set forth as follows:

Range of Exercise Prices	Options Outstanding	Weighted- Average Remaining Life in Years	Weighted- Average Exercise Price Per Share	Options Exercisable
\$0.15	1,421,875	7.3	\$0.15	735,313
\$0.23	589,000	8.2	\$0.23	139,750
\$1.88	75,000	9.0	\$1.88	18,750
\$2.07	75,000	9.3	\$2.07	-
\$2.08	836,500	9.2	\$2.08	-
\$2.80	75,000	2.8	\$2.80	-
\$7.13	25,000	0.3	\$7.13	25,000

Unrecognized Share-Based Compensation Expense

As of December 31, 2010, there was approximately \$1,394,411 of total unrecognized compensation expense related to non-vested share-based compensation arrangements granted under the Equity Compensation Plans. This expense is expected to be recognized over a weighted-average period of 2.6 years as follows:

2011	\$ 772,434
2012	406,922
2013	183,282
2014	<u>31,773</u>
	<u>\$ 1,394,411</u>

On February 26, 2009, the Company granted to its employees options to purchase 629,000 shares of the Company's common stock at an exercise price of \$0.23 per share. The stock options vest over four years, and expire on February 25, 2019. The fair market value of such stock options was \$0.20 per stock option based on the Black-Scholes valuation model.

On December 14, 2009, the Company granted a new employee an option to purchase 75,000 shares of the Company's common stock at an exercise price of \$1.88 per share. The stock options vest over four years and expire on December 13, 2019. The fair market value of such stock options was \$1.81 per stock option based on the Black-Scholes valuation model.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 7: Share-Based Compensation (Continued)

Unrecognized Share-Based Compensation Expense (Continued)

On March 23, 2010, the Company granted to its employees and Key Advisors (as defined under the 2006 Stock Option Plan) stock options to purchase 840,000 shares of the Company's common stock at an exercise price of \$2.08 per share. The stock options vest over four years and expire on March 22, 2020. The fair market value of such stock options was \$2.08 per stock option based on the Black-Scholes valuation model.

On April 12, 2010 and May 10, 2010, the Company granted each of two new employees an option to purchase 75,000 shares of the Company's common stock at exercise prices of \$2.07 and \$2.80 per share, respectively. These stock options vest over four years and expire on April 11, 2020 and May 9, 2020, respectively. The fair market value of the shares, using the Black-Scholes valuation model was \$2.06 and \$2.72, respectively.

Note 8: Employee Benefit Plan

On October 1, 2009, the Company instituted a 401(k) defined contribution plan (the "401(k) Plan") under which participants may elect to defer up to 100% of their compensation up to a maximum amount determined annually pursuant to Internal Revenue Service regulations. Employee contributions may begin 90 days after the date of hire and are immediately vested. The 401(k) Plan provides a safe harbor basic match contribution for all eligible employees who make salary deferrals. The match contribution is equal to 100% of the employee's salary deferral up to 4% of such employee's annual deferred compensation. This match contribution is credited to the employee's account plans and is 100% vested. A total of approximately \$9,000 of match contribution expense was reported for the year ended December 31, 2009 and approximately \$51,000 for the year ended December 31, 2010.

Note 9: Segment Data Information and Concentrations of Business Risk

Segment Information

Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance. Utilizing these criteria, the Company has identified its reportable segments based on the geographical markets they serve, which is consistent with how the Company operates and reports internally.

The Company has two reportable segments: U.S. operations and The Netherlands operations. The U.S. reportable segment includes a subsidiary in Poland that is considered auxiliary to the U.S. operations

The accounting policies for the segments are the same as those described in the summary of significant accounting policies. The Company accounts for intersegment sales as if the sales were to third parties, that is, at current market prices. The U.S. operating segment is a developer, manufacturer and distributor of enzyme products, proteins, peptides and other bio-molecules derived from genes and a collaborative licensor of enabling proprietary and patented technologies for the development and manufacturing of biological products and use in R&D. The Netherlands operating segment is also a developer of enzyme products, proteins, peptides and other bio-molecules derived from genes and, to date, has mainly invested in R&D activities.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 9: Segment Data Information and Concentrations of Business Risk

Segment Information (Continued)

The following tables summarize the Company's segment and geographical information:

	Year Ended December 31, 2010			
	U.S. Operating Segment	The Netherlands Operating Segment	Eliminations	Total
Total net revenues	\$ 7,477,038	\$ 2,318,817	\$ (1,358,252)	\$ 8,437,602
Income (loss) from operations	(5,689,252)	93,778	-	(5,595,474)
Interest income	56,344	5,229	-	61,573
Interest expenses	(248,319)	-	-	(248,319)
Compensation expense on stock option grants	(750,208)	(137,939)	-	(888,147)
Capital expenditures	-	(188,684)	-	(188,684)
Depreciation and amortization	(162,521)	(164,783)	-	(327,304)
Total assets at December 31, 2010	7,787,726	(6,469,253)	8,906,602	10,225,075

	Year Ended December 31, 2009			
	U.S. Operating Segment	The Netherlands Operating Segment	Eliminations	Total
Total net revenues	\$ 20,448,934	\$ 972,395	\$ -	\$ 21,421,329
Income (loss) from operations	9,400,390	(831,295)	-	8,569,095
Interest income	132,008	9,277	-	141,285
Interest expenses	(219,892)	-	-	(219,892)
Compensation expense on stock option grants	(118,103)	-	-	(118,103)
Capital Expenditures	(22,729)	(71,647)	-	(94,376)
Depreciation and amortization	(182,302)	(126,145)	-	(308,447)
Total assets at December 31, 2009	14,325,518	1,078,930	(1,046,580)	14,357,868

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 9: Segment Data Information and Concentrations of Business Risk (Continued)

Concentrations

The Company's credit risks consist primarily of cash and cash equivalents and uncollateralized accounts receivables. The Company performs periodic credit evaluations of its customers' financial condition and provides allowances for doubtful accounts as required.

At times, the Company has cash and cash equivalents at financial institutions exceeding the Federal Depository Insurance Company ("FDIC") insured limit. The Company has not experienced any losses on these accounts. At December 31, 2010 and 2009, amounts on deposit at financial institutions exceeded the FDIC insured limit by approximately \$3,068,000 and \$7,361,000, respectively.

For the years ended December 31, 2010 and 2009, there was one customer that accounted for 10% or greater of net sales, which represented approximately 14% and 13%, respectively, of total net revenue related to product sales.

As of December 31, 2010 and 2009, there were two customers whose trade receivable balance accounted for 10% or greater of the total accounts receivable, which represented in the aggregate approximately 37% and 28%, respectively, of the trade receivable balance.

The Company conducts operations in The Netherlands through its foreign subsidiary (*Note 1*). The net assets of the Company as of December 31, 2010 that have foreign currency exchange exposure and the related foreign currencies are as follows: a favorable difference of approximately 1,051,000 Euros and an unfavorable difference of 26,000 Polish Zloty, respectively.

The Company generates a large portion of its product sales to customers that are located outside the U.S. Sales to external customers whose corporate offices are outside the U.S., totaled approximately \$5,723,000 and \$5,283,000 for the years ended December 31, 2010 and 2009, respectively (*Note 5*).

The Company does not own enzyme manufacturing facilities and relies on third party contract manufacturers to produce all of its enzymes. The Company has and will continue to utilize third party manufacturers to fulfill its future production needs. In order to grow its business, the Company will require additional manufacturing capacity. There is no assurance that the Company will be able to maintain its current manufacturing capacity or be able to secure additional capacity on acceptable terms and conditions as and when needed by the Company. Any interruption in or failure to secure such manufacturing capacity could have a material adverse effect on the Company's results of operations.

For the years ended December 31, 2010 and 2009, there was one vendor that accounted for 10% or greater of purchases, which represented approximately 27% and 30%, respectively, of total purchases.

Note 10: Income Taxes

No provision for U.S income taxes has been recognized for the year ended December 31, 2010 as the Company has incurred operating losses and has established a full valuation allowance. The Company's operations in The Netherlands are subject to income taxes in those jurisdictions.

There was no provision or benefit for either U.S. or foreign current or deferred income taxes for the years ended December 31, 2010 and 2009.

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 10: Income Taxes (Continued)

The U.S. and foreign components of income (loss) from operations before income taxes consisted of the following for the years ended December 31:

	2010	2009
United States	\$ (5,579,930)	\$ 6,063,032
Foreign	51,998	(822,018)
	\$ (5,527,932)	\$ 5,241,014

The primary difference between the Company's income tax benefit computed at the U.S. statutory rate of 35% and the effective tax rates for the years ended December 31, 2010 and 2009 is the change in the valuation allowance in the respective periods that results from the Company fully offsetting the deferred income tax benefit of its net operating losses.

A reconciliation of the Company's income tax provision (benefit) to amounts calculated at the federal statutory rate is as follows for the years ended December 31:

	2010	2009
Federal statutory taxes	(35.00)%	35.00%
State income taxes, net of federal tax benefit	(3.58)	3.58
Correction to net operating loss	8.50	22.80
Nondeductible items	0.43	(0.03)
Change in valuation allowance	29.65	(61.35)
	- %	- %

The significant components of the Company's net deferred tax assets and liabilities consisted of the following as of December 31:

	2010	2009
Current tax assets and liabilities:		
Allowance for Doubtful Accounts	\$ 60,000	\$ 82,000
Inventory reserves	47,000	210,000
Accrued stockholder litigation	-	1,254,000
Other items, net	80,000	86,000
Incentive stock options	260,000	91,000
Depreciation and amortization	(34,000)	91,000
	413,000	1,814,000
Non-current tax assets and liabilities:		
Net operating loss and tax credit carryforwards	23,510,000	20,455,000
Valuation allowance	(23,923,000)	(22,269,000)
Net deferred tax assets	\$ -	\$ -

Dyadic International, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 10: Income Taxes (Continued)

GAAP requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all the evidence, both positive and negative, management has determined that a full valuation allowance of approximately \$23,923,000 and \$22,269,000 against its net deferred taxes is necessary as of December 31, 2010 and 2009, respectively. The increase (decrease) in valuation allowance for the years ended December 31, 2010 and 2009 was approximately \$1,654,000 and (\$3,222,000), respectively.

At December 31, 2010, the Company had approximately \$60,938,000 of U.S. net operating loss carryforwards remaining, which will expire beginning in 2022. As a result of certain ownership changes, the Company may be subject to an annual limitation on the utilization of its U.S. net operating loss carryforwards pursuant to Section 382 of the Internal Revenue Code. A study to determine the effects of this change, if any, has not been undertaken.

Note 11: Subsequent Events

Issuances of Employee Stock Options

On February 28, 2011, the Company granted to its employees and board directors stock options to purchase 1,169,500 shares of the Company's common stock at an exercise price of \$1.93 per share. The stock options vest over four years, and expire on February 27, 2021. The fair market value of such stock options was \$1.73 per stock option based on the Black-Scholes valuation model.