

DYADIC INTERNATIONAL, INC.

Consolidated Financial Statements

December 31, 2009 and 2008

DYADIC INTERNATIONAL, INC.
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DECEMBER 31, 2009 AND 2008

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheet of Dyadic International, Inc. as of December 31, 2009 and the related consolidated statements of income, stockholders' equity and cash flows for the year then ended. The consolidated financial statements of the Company as of December 31, 2008 were audited by other auditors, Goldstein Lewin & Co. whose shareholders became shareholders of Mayer Hoffman McCann P.C. as of January 1, 2010, and whose report dated October 26, 2009, expressed an unqualified opinion on those statements. Dyadic International, Inc.'s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit 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 audit provides 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. as of December 31, 2009, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Mayer Hoffman McCann

MAYER HOFFMAN MCCANN
Certified Public Accountants
Boca Raton, Florida
March 24, 2010

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS	December 31,	
	2009	2008
Current Assets:		
Cash and Cash Equivalents	\$ 8,419,934	\$ 2,826,542
Restricted Cash	316,129	344,355
Accounts Receivable, Net	1,376,034	1,504,200
Inventory, Net	2,820,381	3,775,750
Prepaid Expenses and Other Current Assets	420,654	637,202
Total Current Assets	13,353,132	9,088,049
Fixed Assets, Net	839,639	1,039,458
Intangible Assets, Net	148,167	162,420
Other Assets	16,930	137,502
	\$ 14,357,868	\$ 10,427,429
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	\$ 1,949,038	\$ 2,678,794
Accrued Expenses	713,163	325,634
Accrued Stockholder Litigation	3,250,000	-
Accrued Interest Payable to Stockholder	59,838	194,260
Deferred Research and Development Obligation	-	3,332,863
Note Payable to Stockholder	1,424,941	2,424,941
Income Taxes Payable	767	8,658
Total Current Liabilities	7,397,747	8,965,150
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 – 30,613,995 and 29,990,675, Respectively	30,614	29,991
Additional Paid-In Capital	76,075,899	75,843,581
Stock to Be Issued	23,887	-
Accumulated Deficit	(69,170,279)	(74,411,293)
Total Stockholders' Equity	6,960,121	1,462,279
	\$ 14,357,868	\$ 10,427,429

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,	
	2009	2008
Revenue:		
License Revenue	\$ 10,300,000	\$ -
Product Related Revenue, Net	6,800,071	9,156,529
Research and Development Revenue	4,321,258	3,958,546
Total Revenue	21,421,329	13,115,075
Cost of Goods Sold:	5,774,348	9,112,945
Gross Profit	15,646,981	4,002,130
Expenses:		
General and Administrative	4,050,485	9,733,989
Sales and Marketing	1,152,972	2,344,736
Research and Development	1,817,974	4,102,516
Foreign Currency Exchange Losses, Net	56,455	24,153
Total Expenses	7,077,886	16,205,394
Income (Loss) from Operations	8,569,095	(12,203,264)
Other Income (Expense)		
Interest Income	141,811	145,765
Interest Expense	(219,892)	(388,980)
Loss on Stockholder Litigation	(3,250,000)	-
Other	-	80,081
Total Other Income (Expense)	(3,328,081)	(163,134)
Net Income (Loss)	\$ 5,241,014	\$ (12,366,398)
Net Income (Loss) Per Common Share:		
Basic	\$ 0.17	\$ (0.41)
Diluted	\$ 0.16	\$ (0.41)
Weighted Average Common Shares Used in Calculating Net Income (Loss) Per Share:		
Basic	30,121,396	29,990,675
Diluted	33,231,170	29,990,675

The Accompanying Notes are an Integral Part
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DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Stock to Be Issued</u>	<u>Accumulated Deficit</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Balance at December 31, 2007	29,990,675	\$ 29,991	\$ 75,517,205	\$ -	\$ (62,044,895)	\$ 13,502,301
Amortization of Deferred compensation On Employee and Nonemployee Stock Options	-	-	326,376	-	-	326,376
Net (Loss)	-	-	-	-	(12,366,398)	(12,366,398)
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	<u>30,613,995</u>	<u>\$ 30,614</u>	<u>\$ 76,075,899</u>	<u>\$ 23,887</u>	<u>\$ (69,170,279)</u>	<u>\$ 6,960,121</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,	
	2009	2008
Operating Activities		
Net Income (Loss)	\$ 5,241,014	\$ (12,366,398)
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by (Used In)		
Operating Activities:		
Depreciation and Amortization of Fixed Assets	294,194	286,656
Amortization of Intangible and Other Assets	14,253	51,722
Amortization of Costs Related to Modification of Notes Payable to Stockholder	-	20,200
Loss on Stockholder Litigation	3,250,000	
Provision for Doubtful Accounts	(55,550)	255,000
Inventory Reserve	(842,587)	226,712
Compensation Expense on Stock Option Grants	118,103	326,376
Stock Issued for Consulting Services	31,521	-
Changes in Operating Assets and Liabilities:		
Accounts Receivable	183,716	(348,129)
Inventory	1,797,956	2,120,296
Prepaid Expenses and Other Current Assets	216,548	157,116
Other Assets	120,573	44,907
Accounts Payable	(729,756)	737,040
Accrued Expenses	387,529	(1,194,489)
Accrued Interest Payable to Stockholder	(134,422)	145,364
Deferred Research and Development Obligation	(3,332,863)	(3,332,500)
Income Taxes Payable	(7,892)	2,202
Net Cash Provided By (Used In) Operating Activities	<u>6,552,337</u>	<u>(12,867,925)</u>
Investing Activities		
Cost of Patents	-	(123,805)
Purchases of Fixed Assets	(94,376)	(140,550)
Restricted Cash Deposit	28,227	4,838
Net Cash (Used In) Investing Activities	<u>(66,149)</u>	<u>(259,517)</u>
Financing Activities		
Payment to Stockholder on Note Payable	(1,000,000)	-
Proceeds from Stock Warrant Exercises	86,654	-
Proceeds from Stock Option Exercises	20,550	-
Net Cash (Used In) Financing Activities	<u>(892,796)</u>	<u>-</u>
Net Increase (Decrease) in Cash and Cash Equivalents From Continuing Operations	5,593,392	(13,127,442)
Cash and Cash Equivalents at Beginning of Period	<u>2,826,542</u>	<u>15,953,984</u>
Cash and Cash Equivalents at End of Period	<u>\$ 8,419,934</u>	<u>\$ 2,826,542</u>
Supplemental Cash Flow Information:		
Cash Paid for Interest	<u>\$ 354,314</u>	<u>\$ 359,735</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 an early-stage biotechnology company headquartered in Jupiter, Florida with operations in the United States (“U.S.”), the Netherlands and Poland (*Note 6*). Dyadic has 34 full-time employees, 21 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 products and solutions for the bioenergy, industrial enzyme, and biopharmaceutical industries. Dyadic recognizes substantially all of its revenues from (1) the licensing of its patented and proprietary technologies, (2) the sale 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 manufacturing and/or utilizing the enzymes and proteins 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 biofuels such as cellulosic ethanol and butanol as well as chemicals, polymers and plastics and may provide a 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 of other biological products for the biopharmaceutical industry such as antibodies, proteins, enzymes and polypeptides. By utilizing a proprietary host organism, the C1 Platform Technology may be used as a “one-stop shop” to discover and express the genes of complex living organisms which can then be manufactured for commercial applications.

The Company’s current patent portfolio consists of five U.S. and 60 foreign patents, ten pending U.S. and 34 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 development 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 license deals, 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 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.

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.

In May 2005, the Company formed Dyadic Real Estate Holdings, Inc., a Florida corporation ("DREH") and wholly owned subsidiary, to which it assigned a contract relating to an undeveloped parcel of land purchased by the Company in Jupiter, Florida. Following the sale of this land by DREH in July 2007, DREH was dissolved in January 2008.

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

Note 1: Organization and Operations (Continued)

Historical Results of Operations

The Company generated net income in 2009 of \$5,241,014. In prior years, the Company has incurred losses from operations, which have resulted in an accumulated deficit of \$69,170,279 and \$74,411,293 as of December 31, 2009 and 2008, respectively. The Company attributes the majority of the profits in 2009 to revenues associated with licensing transactions while attributing its operating losses in previous years to discretionary R&D expenditures to improve the C1 Platform Technology and other proprietary technologies as well as significantly increased legal and other costs associated with the discovery of alleged improprieties at the Company's Asian subsidiaries in April 2007 and subsequent related events (*Note 3*). In order to advance its science and to develop new products, the Company has continued to incur discretionary R&D expenditures which the Company believes will continue in 2010 and beyond.

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 generally accepted accounting principles in the U.S. ("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 \$316,000 and \$344,000 at December 31, 2009 and 2008, respectively, which is reserved for the build-out of the Company's laboratory in the Netherlands (*Note 6*).

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.

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

Note 2: Summary of Significant Accounting Policies (Continued)

Accounts Receivable (Continued)

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 its customers experience economic difficulties, actual collection experience 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.

Accounts receivable consisted of the following at December 31:

	<u>2009</u>	<u>2008</u>
Accounts receivable	\$ 1,588,064	\$ 1,774,200
Less: Allowance for doubtful accounts	<u>(212,030)</u>	<u>(270,000)</u>
	<u>\$ 1,376,034</u>	<u>\$ 1,504,200</u>

Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk include cash and cash equivalents and accounts receivable (*Note 10*). The Company invests its excess cash in money market funds. The Company's investments are not insured or guaranteed by the U.S. Government, the Federal Deposit Insurance Corporation or any other government agency.

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 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>2009</u>	<u>2008</u>
Finished goods	\$ 3,147,516	\$ 4,516,737
Raw materials	<u>216,660</u>	<u>645,395</u>
	3,364,176	5,162,132
Less reserve for obsolescence	<u>(543,795)</u>	<u>(1,386,382)</u>
	<u>\$ 2,820,381</u>	<u>\$ 3,775,750</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)	2009	2008
Lab and manufacturing equipment	3 – 10	\$ 2,936,239	\$ 2,868,106
Furniture and fixtures	3 – 7	300,372	290,043
Leasehold improvements	5	93,278	93,278
Vehicles	4 – 5	17,084	17,084
		<u>3,346,973</u>	<u>3,268,510</u>
Less accumulated depreciation and Amortization		<u>(2,507,334)</u>	<u>(2,229,053)</u>
		<u>\$ 839,639</u>	<u>\$ 1,039,458</u>

Depreciation and amortization expense of fixed assets for the years ended December 31, 2009 and 2008 was approximately \$294,000 and \$287,000, respectively, of which approximately \$108,000 and \$120,000, respectively, was included in cost of goods sold and approximately \$186,000 and \$167,000, 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. Approximately \$124,000 in 2008 related to the patents and technology were capitalized. No costs related to patents and technologies were capitalized in 2009. Amortization expense was approximately \$14,000 and \$52,000, respectively, for the years ended December 31, 2009 and 2008.

Intangible assets consisted of the following at December 31:

	2009	2008
Patents	\$ 712,394	\$ 712,394
Less: Accumulated amortization	<u>(564,227)</u>	<u>(549,974)</u>
	<u>\$ 148,167</u>	<u>\$ 162,420</u>

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, 2009 and 2008, respectively.

Accrued Expenses

Accrued expenses consisted of the following at December 31:

	<u>2009</u>	<u>2008</u>
Accrued bonuses, wages, and benefits	\$ 395,915	\$ 37,070
Accrued expenses relating to vendors and others	<u>317,248</u>	<u>288,564</u>
	<u>\$ 713,163</u>	<u>\$ 325,634</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 to stockholder, approximate their fair value due to the short-term nature of these assets and liabilities. The note payable to stockholder approximates fair value based upon its short maturity 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.

Product Revenue

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.

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

Note 2: Summary of Significant Accounting Policies (Continued)

Product Revenue (Continued)

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 the effects of these claims to date have not been material to the Company, it is possible that current and future liability claims could have a material effect on its consolidated financial position, consolidated results of operations or 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 million.

Collaborative Revenue

Revenues under the Abengoa R&D Agreement (as defined below) (*Note 4*) are recognized on a gross basis. The Company is the primary obligor of this agreement because it is responsible for the selection, negotiation, contracting and payment of the third party suppliers. R&D revenues are recognized as activities are performed under the terms of the related agreement. As of December 31, 2009 and 2008, the Company had approximately \$0 and \$3,333,000, respectively, in deferred R&D obligations related to the Abengoa R&D Agreement. The Company recognized approximately \$3,333,000 in research and development revenue for each of the years ended December 31, 2009 and 2008, respectively.

License Revenue

The Company defers upfront and milestone payments received and recognizes revenue as products are delivered, services are rendered ratably over the requisite service periods and/or performance criteria as set forth in the Codexis License Agreement and the Abengoa Agreements (as defined below) (*Note 4*) are met. For the year ended December 31, 2009, the Company recognized \$10.0 million in license revenue from the Codexis License Agreement. No license revenue was recognized during the year ended December 31, 2008.

Research and Development

R&D costs related to both present and future products are charged to operations when incurred. Revenue received for R&D is recognized as the Company meets its obligations under the related agreement.

R&D costs incurred by type of project during the years ended December 31, 2009 and 2008, respectively, were as follows:

	<u>2009</u>	<u>2008</u>
Internal R&D	\$ 1,508,492	\$ 1,741,402
Collaborations with third parties	<u>309,482</u>	<u>2,361,114</u>
	\$ <u>1,817,974</u>	\$ <u>4,102,516</u>

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

Note 2: Summary of Significant Accounting Policies (Continued)

Research and Development (Continued)

R&D expense based upon type of cost incurred during the years ended December 31, 2009 and 2008, respectively, were as follows:

	2009	2008
Personnel related	\$ 792,790	\$ 1,018,641
Laboratory and supplies	190,816	245,194
Outside services	309,482	2,361,114
Facilities, overhead and other	524,886	477,567
	\$ 1,817,974	\$ 4,102,516

The Company recognized approximately \$4,321,000 and \$3,959,000 in R&D revenue for the years ended December 31, 2009 and 2008, respectively.

Advertising Costs

Advertising costs are expensed as incurred. During the years ended December 31, 2009 and 2008, respectively, advertising costs incurred by the Company totaled approximately \$5,000 and \$15,000, respectively, and are included in sales and marketing expenses in the accompanying consolidated statements of operations.

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 to operations 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 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 adoption of this guidance did not have a significant impact on the Company's consolidated financial statements.

Net Income (Loss) Per Share

Basic and diluted net income (loss) per share have been computed using the weighted-average number of shares of common stock outstanding during the periods presented.

The following potentially dilutive securities were not included in the calculation of diluted net income (loss) per share as they were anti-dilutive, based on common stock prices of \$0.15, \$0.23, and \$1.88 per share at December 31, 2009 and 2008, respectively, for the respective periods presented:

	2009	2008
Instruments to purchase common stock:		
Stock options outstanding	75,000	-
Warrants outstanding (<i>Note 8</i>)	-	-
	75,000	-
Total shares of common stock considered anti-dilutive	75,000	-

There were contingently issuable shares under the Development Agreement (as defined below) for the performance of R&D activities by the CRO (as defined below) on behalf of the Company (*Note 6*), of which approximately 0 and 30,136 are also excluded from the calculation of net loss per share for the years ended December 31, 2009 and 2008, respectively. Such shares of common stock are unearned, non-vested or restricted shares that will be considered outstanding once earned under the Development Agreement.

Recent Accounting Pronouncements

In December 2007, the FASB ratified EITF Issue No. 07-1, *Accounting for Collaborative Arrangements* ("EITF Issue No. 07-1"). EITF Issue No. 07-1 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF Issue No. 07-1 also establishes the

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

Note 2: Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

appropriate income statement presentation and classification for joint operating activities and payments between participants, as well as the sufficiency of the disclosures related to these arrangements. EITF Issue No. 07-1 is effective for fiscal years beginning after December 15, 2008, and shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. The Company adopted EITF Issue No. 07-1 effective January 1, 2009 which did not have a material impact on the Company's consolidated financial statements.

In June 2008, FASB revised and amended the consolidation guidance for variable interest entities. The revised and amended guidance is effective for fiscal years beginning after November 15, 2009. The Company is currently evaluating the impact, if any, of the adoption of the revised and amended guidance on its consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update 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.

Note 3: Significant Events

SEC Filings and Reporting

On April 23, 2007, following the discovery of alleged improprieties at the Company's Asian subsidiaries which were abandoned in 2007, the Board, upon the recommendation of its audit committee (the "Audit Committee"), its outside legal counsel and auditors, announced that the Company's previously filed financial statements, including those contained in its Annual Reports on Form 10-KSB ("Annual Reports") and Quarterly Reports on Form 10-QSB ("Quarterly Reports"), as filed with the United States Securities and Exchange Commission ("SEC"), should no longer be relied upon. The Company was subsequently unable to make timely filings with the SEC of its Quarterly Reports or its Annual Report.

Upon the recommendation of its outside legal counsel, the Company also suspended indefinitely the use of its previously filed registration statement on Form S-3 covering the resale of shares of its common stock by investors who participated in a private placement transaction in 2006. Upon the recommendation of its outside legal counsel, the Company had discussions and voluntarily shared the foregoing and other information and documents with the SEC (*Note 6*).

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

Note 3: Significant Events (Continued)

American Stock Exchange Delisting; Resumption of Trading

Since January 16, 2008, the Company's common stock has been quoted and traded on 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 Pink Sheets, 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 Pink Sheets has or will reflect true value. There also can be no assurance that a market in the Company's shares (whether on the Pink Sheets or any other trading or quotation system) will develop or, if such a market develops, that it will continue.

On January 30, 2008, the American Stock Exchange ("AMEX") filed a Form 25 with the SEC to remove the Company's common stock from listing on the AMEX and to withdraw the registration of the Company's common stock under Section 12(b) of the Securities Exchange Act of 1934 (the "1934 Act"). The AMEX delisting took effect on February 11, 2008 and the withdrawal of registration under Section 12(b) took effect on April 29, 2008. As a result, the Company became a non-reporting issuer and is currently not required to file reports with the SEC under Section 13 or 15(d) of the 1934 Act. The Company currently has no timetable for when, or if, it may resume being an SEC reporting company.

Note 4: 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. ("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 considered to be 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 6*). 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 not less than \$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 having a term of three years in accordance with the terms of the Abengoa Securities Purchase Agreement. At December 31, 2009 and 2008, none of these warrants had been exercised (*Note 8*).

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

Note 4: Significant Agreements (Continued)

Abengoa Agreements (Continued)

On February 18, 2009, the Company and Abengoa mutually agreed to terminate the Abengoa R&D Agreement, enter into a non-exclusive license agreement (the "Abengoa License Agreement") and release certain claims between the parties in the ABNT Litigation (as defined below) (collectively, the "Abengoa Events") (Note 6). Under the Abengoa License Agreement, the Company granted Abengoa the right to use certain patent rights and know-how owned by the Company 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, at which time 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.

At December 31, 2008, unused proceeds of approximately \$3,333,000, were recorded as deferred R&D obligations in the accompanying consolidated balance sheets and was recognized in 2009 as a result of the termination of the Abengoa R&D Agreement.

Codexis License Agreement

On November 14, 2008, the Company entered into a non-exclusive license agreement (the "Codexis License Agreement") with Codexis, Inc. ("Codexis") covering use of Dyadic's C1 Platform Technology for the development and large-scale production of enzymes in certain fields including, but not limited to, biofuels and chemical and pharmaceutical intermediate production. Codexis is a clean technology company which develops biocatalysts used to create powerful, efficient and cleaner chemistry-based manufacturing processes in the life sciences, bioindustrial and chemical marketplaces. Codexis technology is used by global pharmaceutical companies for cost-effective manufacturing of human therapeutics and in the energy industry to enable advanced biofuels.

The Codexis License Agreement provides for the payment of \$10 million (the "Codexis Upfront Payment") provided that certain performance criteria are satisfied by the Company. The Company is 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 entire Codexis Upfront Payment is non-refundable provided that the Company meets certain performance criteria. The Company satisfied these criteria on April 15, 2009, and received the Codexis Upfront Payment in full.

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 (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

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

Note 4: Significant Agreements (Continued)

Codexis License Agreement (Continued)

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 5: 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 for the benefit of the MAE Trust which matured 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 Agreement").

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") (*Note 8*). 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. On April 30, 2006, the maturity date of the Revolving Note was extended to January 1, 2008 and on March 21, 2007, the maturity date was extended to January 1, 2009. The remaining unamortized portion of approximately \$26,000 of the beneficial conversion feature was amortized during 2008 through this new maturity date. There was no amortization in 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.

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. The Note matured on January 1, 2009 and 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 4*); and 50% or such lesser percentage as the MAE Trust is willing to accept of each

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

Note 5: Note Payable to Stockholder (Continued)

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 4*). At December 31, 2008, the principal amount outstanding under the Note was approximately \$2.4 million with accrued interest payable to stockholder of approximately \$194,000. Interest expense on the Note, excluding the amortization of the beneficial conversion feature, was approximately \$213,000 and \$336,000, respectively, for the years ended December 31, 2009 and 2008.

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 superseded the Security Agreement. Among other things, the Loan Agreement secures the borrowings under the Note with all of the assets of the Company and 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 8*).

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 matured on January 1, 2009. 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, leaving an outstanding principal amount of approximately \$1.4 million as of December 31, 2009 with accrued interest to the stockholder of approximately \$60,000. To date, the MAE Trust has not requested any further repayment of the principal 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.

Note 6: 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 of approximately \$6,000. The lease expires on December 31, 2010.

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. The shares were valued at \$5,000, based on the then current price of the Company's common stock (*Note 7*).

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

Note 6: Commitments and Contingencies (Continued)

Leases (Continued)

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 June 30, 2013.

Greensboro, North Carolina Laboratory

The Company leases a laboratory facility and a storage building in Greensboro, North Carolina which consists of 3,150 square feet with a monthly rental rate of approximately \$2,100. The lease expires on December 31, 2010.

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 leases office space in Warsaw, Poland which consists of approximately 237 square feet with a monthly rental rate of approximately \$300, and warehouse space with a monthly rental rate of approximately \$5,000. The charge for storage space is based on the number of pallets stored. On January 29, 2010, Dyadic Poland provided notice to terminate this lease effective April 30, 2010.

Future minimum lease commitments due for facilities and equipment leases under non-cancelable operating leases at December 31, 2009 are as follows:

2010	\$	330,325
2011		186,561
2012		140,141
2013		<u>26,600</u>
	\$	<u>683,627</u>

Rent expense under all operating leases for the years ended December 31, 2009 and 2008 totaled approximately \$ 354,000 and \$483,000, respectively, of which approximately \$43,000 and \$44,000 is included in cost of goods sold and approximately \$311,000 and \$439,000 is included in general and administrative expenses, respectively, in the accompanying consolidated statements of operations.

Manufacturing Commitment

In October 1999, the Company entered into a manufacturing agreement (as amended, the "Polfa Agreement") with Polfa Tarchomin S.A. ("Polfa") for the large-scale manufacture of industrial enzymes

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

Note 6: Commitments and Contingencies (Continued)

Manufacturing Commitment (Continued)

at Polfa's facilities in Warsaw, Poland. Up until August 2008, Polfa had been the Company's main contract manufacturer which had produced most of the Company's enzyme requirements over the previous ten years. The Polfa Agreement required monthly payments based on capacity usage, ultrafiltration costs, disposal costs, raw material costs, and reimbursement of plant modification costs. The Polfa Agreement had a term of ten years with options to renew for three additional ten-year periods. The Polfa Agreement was accounted for as a service agreement and the additional modification costs were treated as an operating lease. Accordingly, annual payments were reflected as a component of cost of goods sold in the annual period in which each payment was due.

In May 2001, the Company agreed to pay Polfa approximately 1.8 million Euros for plant modification costs (the "First Polfa Modification"), payable in monthly installments plus interest at the monthly LIBOR rate (1.08% at December 31, 2008) over a period of seven years. The Company paid a total of approximately 85,000 Euros in 2008, plus interest of 1,000 Euros for the year ended December 31, 2008, and satisfied all of its obligations under the First Polfa Modification as of April 2008.

In October 2006, the Company agreed to pay Polfa approximately 735,000 Euros for further expansion costs, payable in monthly installments of 9,000 Euros plus interest at the monthly LIBOR rate, over a period of seven years (the "Second Polfa Modification"). In 2008, the Company paid Polfa approximately 79,000 Euros which represented nine monthly payments plus interest of 13,000 Euros at the monthly LIBOR rate through September 2008, at which time the Company ceased making these payments. On August 14, 2008, the Company suspended all production with Polfa and mutually agreed to terminate the Polfa Agreement as well as all related agreements and work towards settling any remaining obligations between the companies.

The Company has continued to manufacture enzymes with an alternate 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.

Third Party R&D Commitment

The Company has entered into several agreements with independent third parties to conduct R&D activities on behalf of the Company. Except as described below, none of these agreements are for minimum periods in excess of one year, and are generally cancelable by the Company with advance written notice.

Since 1995, the Company has worked with a third party contract research organization (the "CRO") on various R&D programs pursuant to multiple development agreements. On July 30, 2004, Dyadic-Florida and the CRO entered into a development agreement (as amended, the "Development Agreement") for R&D services not to exceed \$1,250,000. The initial term of the Development Agreement was twenty-six months which was subsequently amended to terminate on April 30, 2007.

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

Note 6: Commitments and Contingencies (Continued)

Third Party R&D Commitment (Continued)

On March 1, 2007, the Development Agreement was extended for an additional year through February 29, 2008, with an option to extend for an additional 12 months. The total cost of the one year extension was approximately \$1,651,000, which was billed to the Company on a monthly basis based upon the actual amount of time incurred by the CRO. Each monthly amount was payable 86% in cash and 14% in unregistered shares of the Company's common stock (the "Equity Amount"). The number of shares issued were equal to the Equity Amount divided by the closing price of \$5.91 of the Company's common stock on March 1, 2007. On September 1, 2009, the Company issued 30,136 shares as payment for additional services rendered in 2007 and 2008 under this extension to the Development Agreement.

The Company has recognized non-cash R&D expense of approximately \$ 26,521 and \$0 for the years ended December 31, 2009 and 2008, respectively, based on the fair market value of the services received for shares of stock on the measurement dates.

On March 1, 2008, the Company and the CRO entered into a new development agreement (as amended, the "2008 Development Agreement") for an initial term of one year and an aggregate cost of \$1,800,000 for R&D services, payable on a monthly basis based on the actual amount of time incurred by the CRO. The 2008 Development Agreement may be terminated by either party without cause upon thirty days written notice. Any amounts due to the CRO or refundable to the Company shall be paid within ten days of the termination. In July 2008, the 2008 Development Agreement was amended to reduce the staffing of the R&D program which reduced the Company's monthly payment to approximately \$31,000 for the remaining seven months of the term.

For the years ended December 31, 2009 and 2008, the Company paid the CRO a total of approximately \$114,000 and \$1,107,000, respectively.

On April 24, 2009, the Company and the CRO amended the 2008 Development Agreement to extend its term until April 30, 2010 for continued use of the CRO's services on an hourly basis as required by the Company. The Company prepaid the CRO \$10,000 against which future technology transfer services could be deducted.

Litigation, Claims and Assessments

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 its discovery of alleged improprieties at its Asian subsidiaries. Both the Company's primary and excess insurance carriers have 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. The Company is pursuing insurance coverage and reimbursement for expenses incurred by the Company relating to the SEC Action but there can be no assurance that the Company will be successful. 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 1934 Act. 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. (Note 3)

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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

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 the termination for cause of his employment agreement dated as of April 1, 2001 (as amended, the "Employment Agreement"), asserting, 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. Both the Company's primary and excess insurance carriers have 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. The Company is pursuing insurance coverage for the Emalfarb Arbitration but there can be no assurance that the Company will be successful. This arbitration is currently stayed indefinitely but may be re-initiated by Mr. Emalfarb at any time.

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 alleges 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 Rufus 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 Defendants along with Mr. Emalfarb and the Company to defend against such claim. Both the Company's primary and excess insurance carriers have 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. The parties to the Class Action Litigation and the insurance carriers are

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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Class Action Stockholder Lawsuit (Continued)

currently in substantive settlement discussions. Contemporaneous with its settlement discussions, the Company continues to vigorously defend against the Class Action Litigation and, absent settlement, will pursue insurance coverage from its insurance carriers but there can be no assurance that the Company will be successful. In connection with the Class Action Litigation, the Company has accrued \$3,250,000 which is included in the consolidated balance sheet at December 31, 2009.

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 4*) pursuant to which Abengoa purchased 2,136,752 shares of the Company's common stock from the Company 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. Both the Company's primary and excess insurance carriers have 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. The Company is pursuing insurance coverage of the ABNT Litigation from its insurance carriers but there can be no assurance that the Company will be successful. The ABNT Litigation was settled and voluntarily dismissed with prejudice on May 13, 2009.

Advancement/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 which currently is claimed to be approximately \$170,000. The Company has repeatedly requested additional necessary information from such legal counsel in order for the Company to determine whether these legal fees and expenses are accurate, reasonable and subject to advancement and indemnification by the Company. To date, such information has not been completely provided to the Company. The Company's insurance policies provide for advancements of defense costs. Both the Company's primary and excess insurance carriers have 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. The Company is pursuing insurance coverage and reimbursement for expenses incurred by the Company relating to the SEC Action and other noticed matters including, but not limited to, expenses incurred by the Defendants listed above for the defense of these actions and indemnification from the Company. Absent settlement of the Class Action Litigation, the Company will also pursue insurance coverage and reimbursement for expenses incurred by the Company in the Class Action Litigation but there can be no assurance in any of these cases that the Company will be successful.

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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (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 has no obligation to provide coverage for the Class Action Litigation. The coverage at issue is an excess policy to the Company that covered the time period from October 27, 2006 to October 27, 2007. The excess carrier has 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 which is currently stayed indefinitely.

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 ("Ernst & Young") and Ernst & Young-Hong Kong, L.P. ("Ernst & Young-Hong Kong"), 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.

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"), Jenkens & 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 Jenkens & 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. In addition to the claims contained in the original complaint, the Amended Complaint contains a claim of civil conspiracy against Ernst & Young, Greenberg Traurig and Mr. Schwimmer. The claims against outside legal counsel are, without limitation, primarily related to the legal consultation and recommendations provided to the Company as set forth in Note 3 of the consolidated financial statements of Dyadic for the year ended December 31, 2008. Ernst & Young-Hong Kong remains to be served in accordance with international law. The Company has sent initial discovery requests to all defendants except for Ernst & Young-Hong Kong.

On September 22, 2009, the Court granted Ernst & Young's motion to compel arbitration and to stay all court proceedings between Ernst & Young and the Company. The remaining defendants other than the Moscowitz Defendants and Ernst & Young-Hong Kong filed motions to dismiss with the Court which were denied. The Moscowitz Defendants filed a motion to compel arbitration with the Court or alternatively to dismiss which was denied. The Moscowitz Defendants have filed a Notice of Appeal of the order denying their motion to compel arbitration which is awaiting decision. The Company has received answers and affirmative defenses to the Amended Complaint from all defendants except Ernst & Young-Hong Kong. The Company has replied to avoid the affirmative defenses under the rules of civil procedure. The Company and the defendants are currently exchanging written discovery.

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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Reimbursement of Legal Expenses

During 2008, the Company reimbursed its Chief Executive Officer, Mark A. Emalfarb, for legal expenses of approximately \$205,000 incurred by Mr. Emalfarb in certain litigation matters described above in which he was or is a party.

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 impacts 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 7: 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 107,000 shares of its common stock on various dates during 2009 based on stock option exercises for total cash proceeds of approximately \$16,050 (*Note 8*).

The Company issued 436,184 shares of its common stock on various dates during 2009 based on warrant exercises for total cash proceeds of approximately \$67,267 (*Note 8*).

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

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

Note 7: Capital Structure (Continued)

Financial Advisor (Continued)

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 has 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. As of December 31, 2009 no shares were issued to the Advisor.

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

Third Party R&D Activities

Since 1995, the Company has worked with the CRO on various R&D programs under multiple development agreements (*Note 6*). In 2009, the Company issued 30,136 shares of its common stock for R&D services provided under the development agreements, valued at approximately \$26,000 based on the fair market value of the Company's common stock on the measurement date for the year ended December 31, 2009. R&D expense under these agreements of \$26,000 and \$135,000 was recognized in 2009 and 2007, respectively.

Note 8: Share-Based Compensation

Issuances of Common Stock

During the year ended December 31, 2009, the Company received an aggregate of approximately \$107,204 in proceeds from the exercises of the following instruments: (i) warrants to purchase an aggregate of 565,434 shares of its common stock at exercise prices of \$0.15 and \$0.16 per share, and (ii) stock options to purchase an aggregate of 137,000 shares of its common stock, granted under the Equity Compensation Plans (as defined below) with an exercise price of \$0.15 per share. These shares included 159,250 shares paid but not yet issued as of December 31, 2009 which are included in the stock to be issued. During the year ended December 31, 2008, the Company received no proceeds from the exercises of stock options or warrants.

Warrants

At December 31, 2009 and 2008, 2,343,333 and 6,775,227 shares of common stock have been reserved for issuance under outstanding warrants. All of the warrants are fully vested and have expiration dates ranging from May 14, 2010 to May 29, 2013. Information concerning the Company's warrant activity is as follows:

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

Note 8: Share-Based Compensation (Continued)

Issuances of Common Stock (Continued)

Warrants (Continued)

	2009		2008	
	Warrants	Weighted-Average Exercise Price	Warrants	Weighted-Average Exercise Price
Outstanding at the beginning of the year	6,775,227	\$ 4.15	6,775,227	\$ 5.11
Retired	(3,866,460)	5.50	(1,818,934)	3.71
Exercised	(565,434)	0.15	-	-
Granted	-	-	1,818,934	0.15
Outstanding at the end of the year	2,343,333	\$ 2.89	6,775,227	\$ 4.15

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, 2009, there were 2,417,500 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

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

Note 8: Share-Based Compensation (Continued)

Description of Equity Plans (Continued)

2001 Equity Plan (Continued)

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, 2009, there were 98,250 stock options outstanding and 4,053,475 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, 2009, there were 2,319,000 stock options outstanding and 2,379,750 available for grant under the 2006 Option Plan. The term of the options outstanding under the 2006 Option Plan is ten years (*Note 12*).

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, 2009 and 2008 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 options. The expected life of the 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 options granted were as follows:

	Year Ended December 31, 2009	Year Ended December 31, 2008
Average Risk-Free Interest Rate	2.98%-3.56%	3.79%
Dividend Yield	0.00%	0.00%
Average Volatility Factor	90.48%-128.91%	70.25%
Average Option Life	10 years	10 years

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

Note 8: Share-Based Compensation (Continued)

Description of Equity Plans (Continued)

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 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, which estimates 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, 2009 and 2008, the Company terminated approximately one and 27 employees, respectively. A cumulative adjustment of \$3,629 was recorded as a reduction to non-cash share-based compensation expense in the Company's results of operations for the year ended December 31, 2009.

The Company considered its historical experience of option forfeitures as the basis to arrive at its estimated average option forfeiture rate of 5% per year for remaining options for the years ended December 31, 2009 and 2008 for all stock option awards. The Company recognized non-cash share-based compensation expense/recovery for its share-based awards of approximately \$118,000 and \$326,000 for the years ended December 31, 2009 and 2008, 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,	
	2009	2008
General and administrative	\$ 91,374	\$ 176,256
Research and development	8,659	32,615
Cost of goods sold	9,346	50,038
Sales and marketing	8,724	67,467
	\$ 118,103	\$ 326,376

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

Note 8: Share-Based Compensation (Continued)

Description of Equity Plans (Continued)

Equity Compensation Plans Awards Activity

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

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding at December 31, 2007	1,834,556	\$ 4.29
Granted	2,008,500	0.15
Exercised	-	-
Expired	(46,000)	4.50
Cancelled	<u>(1,853,556)</u>	4.08
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	<u>(45,500)</u>	0.15
Outstanding at December 31, 2009	<u>2,417,500</u>	\$0.30
Exercisable at December 31, 2009	<u>639,000</u>	\$0.24

The weighted average grant date fair values of stock options granted during the years ended December 31, 2009 and 2008 were \$0.37 and \$0.16 per share, respectively.

Cash received from stock option exercises during the years ended December 31, 2009 and 2008 was \$20,550 and \$0, respectively. The Company has a net operating loss carryforward as of December 31, 2009 and, therefore, no excess tax benefits for tax deductions related to the stock options were recognized.

A further detail of the options outstanding as of December 31, 2009 is set forth as follows:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>	<u>Weighted- Average Remaining Life in Years</u>	<u>Weighted- Average Exercise Price Per Share</u>	<u>Options Exercisable</u>	<u>Weighted- Average Exercise Price Per Share</u>
\$0.15	1,691,000	7.82	\$0.15	614,000	\$0.15
\$0.23	626,500	9.16	\$0.23	-	-
\$1.88	75,000	9.96	\$1.88	-	-
\$7.13	25,000	0.27	\$7.13	25,000	\$7.13

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

Note 8: Share-Based Compensation (Continued)

Description of Equity Plans (Continued)

Unrecognized Share-Based Compensation Expense

As of December 31, 2009, there was \$264,280 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 2.9 years as follows:

Fiscal Year 2010	\$ 143,477
Fiscal Year 2011	75,153
Fiscal Year 2012	36,332
Fiscal Year 2013	<u>9,317</u>
	<u>\$ 264,280</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.

Note 9: Employee Benefit Plan

The Company offered a 401(k) defined contribution plan in which all employees were eligible to participate up until June 15, 2008, at which time the Company ceased offering this benefit to its employees (the "Former 401(k) Plan"). On October 1, 2009, the Company re-instituted a 401(k) defined contribution plan (the "New 401(k) Plan") on substantially the same terms and conditions as the Former 401(k) Plan. Under the New 401(k) Plan, participants may elect to defer up to 100% (as compared to 80% under the Former 401(k) Plan) of compensation up to a maximum amount determined annually pursuant to Internal Revenue Service regulations. Employee contributions may begin ninety days after the date of hire (as compared to on the date of hire under the Former 401(k) Plan) and are immediately vested. The New 401(k) Plan continues to provide 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 (as compared to 3% of compensation, plus 50% of the salary deferral which exceeds 3% but does not exceed 5% of compensation under the Former 401(k) Plan). This match contribution was and is credited to the employee's account in both plans and is 100% vested. A total of approximately \$34,000 of match contribution expense was reported for the year ended December 31, 2008 and approximately \$9,000 for the year ended December 31, 2009 as set forth in the accompanying consolidated statements of operations.

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

Note 10: 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 at current market prices as if the sales were to third parties. 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.

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

	Year Ended December 31, 2009			
	U.S. Operating Segment	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	132,534	9,277	-	141,811
Interest Expenses	(219,892)	-	-	(219,892)
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

	Year Ended December 31, 2008			
	U.S. Operating Segment	Netherlands Operating Segment	Eliminations	Total
Total Net Revenues	\$ 12,589,029	\$ 526,046	\$ -	\$ 13,115,075
Loss from Operations	(10,896,852)	(1,306,412)	-	(12,203,264)
Interest Income	132,724	13,041	-	145,765
Interest Expenses	(388,980)	-	-	(388,980)
Depreciation and amortization	241,212	97,166	-	338,378
Total assets at December 31, 2008	10,408,325	877,578	(858,474)	10,427,429

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

Note 10: Segment Data Information and Concentrations of Business Risk (Continued)

Concentrations

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

For the year ended December 31, 2009, there was one customer that accounted for 10% or greater of net sales, which represented approximately 13% of total net revenue related to product sales. For the year ended December 31, 2008, there were two customers that accounted for 10% or greater of net sales, which represented in the aggregate approximately 30% of total net revenue related to product sales. As of December 31, 2009, there were two customers whose trade receivable balance accounted for 10% or greater of total accounts receivable, which represented in the aggregate approximately 28% of the trade receivable balance. As of December 31, 2008, there was one customer whose trade receivable balance was 42% of total accounts receivable.

The Company conducts operations in Poland and the Netherlands through its foreign subsidiaries (*Note 1*). The net assets of the Company as of December 31, 2009 that have foreign currency exchange exposure and the related foreign currencies are as follows: a favorable difference of approximately 1,095,000 Euros and an unfavorable difference of 360,000 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 attributed to foreign countries, defined as the location of the corporate office of those customers, totaled approximately \$5,283,000 and \$7,505,000 for the years ended December 31, 2009 and 2008, respectively (*Note 6*).

The Company does not own enzyme manufacturing facilities and relies on third party contract manufacturers to produce all of its enzymes. Up until August 2008, the Company's main contract manufacturer had been Polfa located in Warsaw, Poland, which had produced substantially all of the Company's commercial enzymes for the prior ten years until the Polfa Agreement was terminated in August 2008 (*Note 6*). The Company has and will continue to utilize other 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.

Note 11: Income Taxes

No provision for U.S. income taxes has been recognized for the year ended December 31, 2009 as the Company has incurred operating losses and has established a full valuation allowance. The Company's operations in the Netherlands and Poland are subject to income taxes in those jurisdictions.

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

Note 11: Income Taxes (Continued)

The provisions for income taxes consisted of the following as of December 31:

	<u>2009</u>	<u>2008</u>
Current:		
U.S.	\$ -	\$ -
Foreign	-	-
	<u>\$ -</u>	<u>\$ -</u>
Deferred:		
U.S.	-	-
Foreign	-	-
	<u>\$ -</u>	<u>\$ -</u>

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

	<u>2009</u>	<u>2008</u>
United States	\$ 6,063,032	\$ (10,230,133)
Other foreign	(822,018)	(2,136,265)
	<u>\$ 5,241,014</u>	<u>\$ (12,366,398)</u>

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

	<u>2009</u>	<u>2008</u>
Current tax assets and liabilities:		
Allowance for doubtful accounts	\$ 82,000	\$ 104,000
Inventory reserves	210,000	471,000
Accrued stockholder litigation	1,254,000	-
Other items, net	86,000	(22,000)
Incentive stock options	91,000	91,000
Depreciation and amortization	91,000	138,000
	<u>1,814,000</u>	<u>782,000</u>
Non-current tax assets and liabilities:		
Net operating loss and tax credit carryforwards	20,455,000	24,709,000
Valuation allowance	(22,269,000)	(25,491,000)
	<u>\$ -</u>	<u>\$ -</u>
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

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

Note 11: 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 \$22,269,000 and 25,491,000 against its net deferred taxes is necessary as of December 31, 2009 and 2008, respectively. The (decrease)/increase in valuation allowance for the years ended December 31, 2009 and 2008 was approximately (\$3,222,000) and \$4,710,000, respectively.

At December 31, 2009, the Company had approximately \$53,019,000 of U.S. net operating loss carryforwards remaining, which will expire beginning in 2021. 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.

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

	2009	2008
Federal statutory taxes	35.00%	35.00%
State income taxes, net of federal tax benefit	3.58	3.58
Correction to net operating loss	22.80	-
Nondeductible items	(0.03)	(0.49)
Change in valuation allowance	(61.43)	(38.09)
	- %	- %

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, 2009 and 2008 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.

We are subject to taxation in the U.S. and various state, local, and foreign jurisdictions. We remain subject to examination by U.S. Federal, state, local, and foreign tax authorities for tax years 2006 through 2009. With a few exceptions we are no longer subject to U.S. Federal, state, local, and foreign examinations by tax authorities for the tax year 2005 and prior. However, net operating losses from the tax year 2005 and prior would be subject to examination if and when used in a future tax return to offset taxable income.

Note 12: Subsequent Events

Issuances of Common Stock

On March 23, 2010, the Company granted to its employees stock options to purchase 715,000 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 \$2.01 per stock option based on the Black-Scholes valuation model.