



DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES

Condensed Consolidated Financial Statements

June 30, 2010

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
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DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	<u>June 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
ASSETS	(Unaudited)	
Current Assets:		
Cash and Cash Equivalents	\$ 3,964,486	\$ 8,419,934
Restricted Cash	270,540	316,129
Accounts Receivable, Net	1,626,781	1,376,034
Inventory, Net	2,754,425	2,820,381
Prepaid Expenses and Other Current Assets	<u>302,867</u>	<u>420,654</u>
Total Current Assets	8,919,099	13,353,132
Fixed Assets, Net	845,858	839,639
Intangible Assets, Net	147,383	148,167
Other Assets	<u>16,930</u>	<u>16,930</u>
	<u>\$ 9,929,270</u>	<u>\$ 14,357,868</u>
 LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	\$ 1,882,804	\$ 1,949,038
Accrued Expenses	279,133	713,163
Accrued Stockholder Litigation	1,340,000	3,250,000
Accrued Interest Payable to Stockholder	33,750	59,838
Note Payable to Stockholder	1,424,941	1,424,941
Income Taxes Payable	<u>2,005</u>	<u>767</u>
Total Current Liabilities	<u>4,962,633</u>	<u>7,397,747</u>
 COMMITMENTS AND CONTINGENCIES		
Stockholders' Equity:		
Preferred Stock, \$.0001 Par Value:		
Authorized Shares – 5,000,000; None Issued and	-	-
Common Stock, \$.001 par value,		
Authorized Shares – 100,000,000; Issued and		
Outstanding – 31,006,995 and 30,613,995, Respectively	31,007	30,614
Additional Paid-In Capital	76,617,987	76,075,899
Stock to Be Issued	9,117	23,887
Accumulated Deficit	<u>(71,691,474)</u>	<u>(69,170,279)</u>
	<u>4,966,637</u>	<u>6,960,121</u>
	<u>\$ 9,929,270</u>	<u>\$ 14,357,868</u>

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

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	<u>Six Months Ended June 30,</u>		<u>Three Months Ended June 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue:				
Product Related Revenue, Net	\$ 3,618,937	\$ 3,210,964	\$ 1,739,792	\$ 1,754,765
License Fee Revenue	32,000	9,750,000	-	9,750,000
Research and Development Revenue	553,575	3,920,801	465,340	396,388
Total Revenue	<u>4,204,512</u>	<u>16,881,765</u>	<u>2,205,132</u>	<u>11,901,153</u>
Cost of Goods Sold:	<u>3,090,979</u>	<u>2,975,786</u>	<u>1,485,650</u>	<u>1,819,789</u>
Gross Profit	<u>1,113,533</u>	<u>13,905,979</u>	<u>719,482</u>	<u>10,081,364</u>
Expenses:				
General and Administrative	2,634,142	1,845,313	1,274,476	1,022,056
Sales and Marketing	472,596	455,457	245,863	184,440
Research and Development	648,634	624,502	362,595	241,300
Foreign Currency Exchange Losses, Net	260,543	50,252	227,246	18,770
Total Expenses	<u>4,015,915</u>	<u>2,975,524</u>	<u>2,110,180</u>	<u>1,466,566</u>
Income (Loss) from Operations	<u>(2,902,382)</u>	<u>10,930,455</u>	<u>(1,390,698)</u>	<u>8,614,798</u>
Other Income (Expense)				
Interest Income	36,012	70,995	14,741	48,116
Interest Expense	(65,066)	(109,866)	(31,687)	(43,316)
Gain on Reduction of Accrued Stockholder Litigation	410,000	-	-	-
Other	243	-	243	(1,198)
Total Other Income (Expense)	<u>381,189</u>	<u>(38,871)</u>	<u>(16,703)</u>	<u>3,602</u>
Net Income (Loss)	<u>\$ (2,521,193)</u>	<u>\$ 10,891,584</u>	<u>\$ (1,407,401)</u>	<u>\$ 8,618,400</u>
Net Income (Loss) per Common Share				
Basic	<u>\$ (0.08)</u>	<u>\$ 0.36</u>	<u>\$ (0.05)</u>	<u>\$ 0.29</u>
Diluted	<u>\$ (0.08)</u>	<u>\$ 0.33</u>	<u>\$ (0.05)</u>	<u>\$ 0.26</u>
Weighted Average Common Shares Used in Calculating Net Income (Loss) Per Share:				
Basic	<u>30,906,706</u>	<u>30,027,962</u>	<u>30,985,745</u>	<u>30,002,830</u>
Diluted	<u>30,906,706</u>	<u>32,936,567</u>	<u>30,985,745</u>	<u>33,218,934</u>

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

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

	Six Months Ended June 30,	
	2010	2009
	(Unaudited)	(Unaudited)
Operating Activities		
Net Income (Loss)	\$ (2,521,193)	\$ 10,891,584
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided By (Used In) Operating Activities:		
Depreciation and Amortization of Fixed Assets	151,096	87,682
Amortization of Intangible and Other Assets	7,068	7,067
Reduction of Allowance for Doubtful Accounts	(132,030)	-
Reduction of Inventory Reserve	(333,795)	(490,414)
Compensation Expense on Stock Option Grants	425,032	58,025
Stock Issued for Financial Services	63,000	-
Stock Issued for Rent	-	5,000
Gain on Reduction of Accrued Stockholder Litigation	(410,000)	-
Changes in Operating Assets and Liabilities:		
Accounts Receivable	(118,717)	(9,247)
Inventory	399,751	1,125,490
Prepaid Expenses and Other Current Assets	117,787	22,105
Other Assets	-	27,604
Accounts Payable	(66,234)	(319,621)
Accrued Expenses	(434,030)	(74,011)
Accrued Interest Payable to Stockholder	(26,088)	(167,154)
Accrued Stockholder Litigation	(1,500,000)	-
Deferred Research and Development Obligations	-	(3,082,863)
Income Taxes Payable	1,238	(5,584)
Net Cash Provided By (Used In) Operating Activities	<u>(4,377,115)</u>	<u>8,075,663</u>
Investing Activities		
Purchases of Fixed Assets	(157,315)	(12,402)
Patent Costs	(6,284)	-
Restricted Cash	45,589	1,197
Net Cash (Used In) Investing Activities	<u>(118,010)</u>	<u>(11,205)</u>
Financing Activities		
Repayment of Note Payable to Stockholder	-	(1,000,000)
Proceeds from Stock Warrant Exercises	16,876	-
Proceeds from Stock Option Exercises	22,801	-
Net Cash Provided By (Used In) Financing Activities	<u>39,677</u>	<u>(1,000,000)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(4,455,448)	7,064,458
Cash and Cash Equivalents at Beginning of Period	8,419,934	2,826,542
Cash and Cash Equivalents at End of Period	<u>\$ 3,964,486</u>	<u>\$ 9,891,000</u>
Supplemental Cash Flow Information:		
Cash Paid for Interest	<u>\$ 91,154</u>	<u>\$ 277,020</u>

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

Note 1: Basis of Presentation

General

The accompanying unaudited interim condensed consolidated financial statements for Dyadic International, Inc. and its Subsidiaries (collectively, “Dyadic” or the “Company”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial reporting. Accordingly, certain information and footnote disclosures normally included in annual consolidated financial statements have been condensed or omitted. In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments and the elimination of intra-entity accounts) considered necessary for a fair statement of all periods presented. The results of Dyadic’s operations for any interim periods are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes for the year ended December 31, 2009.

Net Income (Loss) Per Common Share

Basic income (loss) per share excludes any dilution. It is based upon the weighted average number of common shares outstanding during the period. Diluted income (loss) per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. As of June 30, 2010, 3,153,881 shares of common stock underlying stock options and warrants were not included in computing diluted earnings per share because their effects were anti-dilutive.

Recently Issued Accounting Pronouncements

In April 2010, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2010-17, "Revenue Recognition - Milestone Method (Topic 605): Milestone Method of Revenue Recognition" (codified within ASC 605 - Revenue Recognition). ASU 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. ASU 2010-17 is effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2010 with early adoption permitted. The Company is currently assessing the impact of ASU 2010-17 on its future consolidated financial statements.

Reclassifications

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

Note 2: Inventory

Inventory consists of raw materials and finished goods including industrial enzymes used in the industrial, chemical, and agricultural markets, and are 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.

Note 2: Inventory (Continued)

Inventory consisted of the following:

	June 30, 2010	December 31, 2009
	(Unaudited)	
Finished goods	\$ 2,840,489	\$ 3,147,516
Raw materials	123,936	216,660
	2,964,425	3,364,176
Less reserve for obsolescence	(210,000)	(543,795)
	\$ 2,754,425	\$ 2,820,381

Note 3: Significant Agreements

Abengoa Agreements

On February 18, 2009, the Company and Abengoa Bioenergy New Technologies, Inc. (formerly known as Abengoa Bioenergy R&D, Inc.) (“Abengoa”) mutually agreed to terminate the Abengoa R&D Agreement, enter into a non-exclusive license agreement (the “Abengoa License Agreement”) and settle and release all claims between the parties in the ABNT Litigation (collectively, the “Abengoa Events”). 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 became effective on May 12, 2009 when the Company completed the delivery of certain materials to Abengoa, which was a condition precedent to releasing the Abengoa License Agreement and a settlement agreement between the parties from escrow that made the Abengoa Events effective. The Company recognized research and development revenue related to the proceeds received pursuant to the Abengoa Securities Purchase Agreement of approximately \$0 and \$3,333,000 for the three and six months ended June 30, 2010 and 2009, respectively.

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.

Note 3: Significant Agreements (Continued)

Codexis License Agreement (Continued)

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 as a result of the Company having met certain performance criteria. The Company has recognized license fee revenue related to the Codexis License Agreement of \$0 and \$9,750,000 during the three and six months ended June 30, 2010 and 2009, respectively.

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 and other materials under the Codexis License Agreement. The MAE Trust is a stockholder of the Company whose trustee and beneficiary is the Company’s President, Chief Executive Officer and Chairman of the Board, Mark A. Emalfarb. The Francisco Trust is an entity created for the primary benefit of the wife and children of Mark A. Emalfarb.

Note 4: Note Payable to Stockholder

The Amended and Restated Note dated as of November 14, 2008 (the “Note”) payable to the Mark A. Emalfarb Trust under agreement dated October 1, 1987, as amended (the “MAE Trust”), matured on January 1, 2009 and has not been amended since that time. On January 12, 2009, the Company repaid \$1,000,000 of principal of the Note leaving an outstanding principal amount of approximately \$1.4 million. To date, the MAE Trust has not requested any further repayment of the Note although it is entitled to demand that all unpaid principal and accrued interest on the Note become immediately due and payable. As of January 1, 2010, the MAE Trust and the Company agreed to reduce the interest rate on the outstanding principal balance of the Note from 14% to 9.5% per annum.

Note 5: Commitments, Contingencies and Subsequent Events

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 alleged improprieties at its Asian subsidiaries, which were abandoned in 2007. 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. In consideration for the contribution by the insurance carriers to the proposed settlement of the Class Action Litigation (as defined below), all pending claims with such insurance carriers with respect to the SEC Action have been released. The Company submitted

Note 5: Commitments, Contingencies and Subsequent Events (Continued)

Litigation, Claims and Assessments (Continued)

SEC Action (Continued)

an Offer of Settlement to the SEC which was accepted on June 4, 2009. The Company's Offer of Settlement included the issuance of a cease-and-desist order (the "Order") by the SEC against the Company which directed the Company to cease and desist from committing or causing any violations of certain clauses of the Securities and Exchange Act of 1934, as amended. The Order did not impose any monetary or other penalty on the Company, its officers or directors and the Company did not admit or deny any of the findings contained in the Order.

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. In consideration for the contribution by the insurance carriers to the proposed settlement of the Class Action Litigation (as defined below), all pending claims with such insurance carriers with respect to the Emalfarb Arbitration have been released. 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 alleged violations of Section 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78j(b) and 78t(a) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, based on the alleged failure of the Defendants to disclose in statements to the SEC and to the investing public actual occurrences and risk of financial and operational improprieties by the Company's Asian subsidiaries during the Class Period.

Note 5: Commitments, Contingencies and Subsequent Events (Continued)

Litigation, Claims and Assessments (Continued)

Class Action Stockholder Lawsuit (Continued)

In its Order of November 25, 2008, the Court dismissed the Amended Consolidated Class Action Complaint as to Defendants Richard J. Berman, Harry Z. Rosengart, Stephen J. Warner and Wayne Moor without prejudice. The Court denied the motions to dismiss filed by Defendants Mark A. Emalfarb and the Company.

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

On April 16, 2010, the parties to the Class Action Litigation filed a Stipulation of Settlement with the Court which provides for payment to the alleged class of \$4.8 million to be funded by the Company and its insurance carriers. In consideration for the contribution by the insurance carriers to this proposed settlement, all pending claims with such insurance carriers with respect to the Class Action Litigation have been released. The Stipulation of Settlement was preliminarily approved by the Court on April 20, 2010 and finally approved on July 27, 2010, which resulted in the dismissal of the Class Action Litigation with prejudice. In connection with the Class Action Litigation, the Company accrued \$2,840,000, a portion of which was paid into escrow on April 20, 2010. As of June 30, 2010, the remaining accrual for stockholder litigation amounted to \$1,340,000, which was paid into escrow on July 13, 2010.

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. 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. In consideration for the contributions by the insurance carriers to the resolution of the Class Action Litigation described above, all pending claims with such insurance carriers with respect to the Class Action Litigation and the SEC Action have been released. On April 23, 2010, the Company paid the remaining legal fees and costs of Messrs. Moor, Rosengart and Berman of approximately \$135,000. The Company also agreed to pay their reasonable attorneys' fees and costs to finalize the settlement of the Class Action Litigation up to a maximum of \$25,000 and executed mutual releases with them covering the matters for which Messrs. Moor, Rosengart and Berman and the Company released the insurance carriers. Such amount is included in accrued stockholder litigation in the condensed consolidated balance sheet as of June 30, 2010.

Note 5: Commitments, Contingencies and Subsequent Events (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 indefinitely. As a result of the final approval of the proposed resolution of the Class Action Litigation by the Court on July 27, 2010, this action will be dismissed by mutual agreement.

Professional Liability Lawsuit

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

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. The claims against the Company's former outside legal counsel are for breach of fiduciary duty and professional negligence. In addition to these claims, the Amended Complaint contains a claim of civil conspiracy against Ernst & Young LLP, Greenberg Traurig and Mr. Schwimmer.

On September 22, 2009, the Court granted Ernst & Young LLP's motion to compel arbitration and to stay all circuit court proceedings between Ernst & Young LLP and the Company. A final hearing before the arbitration panel is scheduled for early February 2011.

The remaining defendants in the circuit court action 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 also denied and affirmed on appeal. The Company has received answers and affirmative defenses to the Amended Complaint from all defendants except Ernst & Young-Hong Kong which has moved to compel arbitration. The Motion to Compel Arbitration is scheduled to be heard in September 2010. 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. Depositions are scheduled to commence on August 25, 2010.

Note 5: Commitments Contingencies and Subsequent Events (Continued)

Litigation, Claims and Assessments (Continued)

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. In accordance with GAAP, the Company makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Litigation is inherently unpredictable and costly. While the Company believes that it has valid defenses with respect to the legal matters pending against it, protracted litigation and/or an unfavorable resolution of one or more of such proceedings, claims or investigations against the Company could have a material adverse effect on the Company's consolidated financial position, cash flows or results of operations.

Note 6: Common Stock

Issuances of Common Stock

The Company issued 121,250 shares of its common stock on various dates during the six months ended June 30, 2010, based on stock option exercises for total cash proceeds of approximately \$27,300, of which 30,000 shares of its common stock was previously recorded as stock to be issued with total cash proceeds of approximately \$4,500.

The Company issued 241,750 shares of its common stock during the six months ended June 30, 2010, based on warrant exercises for total cash proceeds of approximately \$36,300, of which 129,250 shares of its common stock were previously recorded as stock to be issued with total cash proceeds of approximately \$19,400.

Financial Advisor

During the six months ended June 30, 2010, the Company issued 30,000 shares of its common stock to a financial advisor for services provided to the Company, which had a value of \$63,000 based on the then current price of the Company's common stock.

Note 7: Share-Based Compensation

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

Note 7: Share-Based Compensation (Continued)

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

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

Average Risk-Free Interest Rate	2.73% - 3.69%
Dividend Yield	0.00%
Average Volatility Factor	325.61% - 424.00%
Average Option Life	10 years

During the three and six months ended June 30, 2010, stock options to purchase 45,875 and 146,500 shares of common stock, respectively, were exercised at an exercise price ranging from \$0.15 to \$0.23 per share. Cash received from stock option exercises during the three and six months was approximately \$7,700 and \$22,800, respectively. There were no stock options that expired or were cancelled during the three and six months ended June 30, 2010. As of June 30, 2010, there were stock options outstanding under the Company's equity plans to purchase 3,285,000 shares of common stock.

The Company recognized non-cash share-based compensation expense for its share-based awards of approximately \$225,000 and \$28,000 for the three ended June 30, 2010 and 2009, respectively and approximately \$425,000 and \$58,000 for the six months ended June 30, 2010 and 2009, respectively. Total non-cash share-based compensation expense was allocated among the following expense categories:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2010	2009	2010	2009
General and administrative	\$ 314,442	\$ 42,100	\$ 166,318	\$ 20,065
Research and development	40,539	4,830	20,381	2,309
Cost of goods sold	33,767	4,949	16,977	2,359
Sales and marketing	36,284	6,146	21,055	2,885
	\$ 425,032	\$ 58,025	\$ 224,730	\$ 27,618

Note 8: Income Taxes

As of June 30, 2010, the Company had significant net operating loss carryforwards remaining that expire beginning in 2021. The Company has determined that a full valuation allowance against its net deferred taxes is necessary as of June 30, 2010.

The Company is subject to income taxes in the U.S. federal jurisdiction, various states jurisdictions and certain other international jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. The Company is not subject to U.S. federal, state and local tax examinations by tax authorities for the years before 2005. If the Company were to subsequently record an unrecognized tax benefit, associated penalties and tax related interest expense would be reported as a component of income tax expense.

Note 9: Segment Data Information

Segment assets consist primarily of other receivables and fixed assets. Summarized financial information for the Company's segments are as follows:

Six Months Ended June 30, 2010			
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 3,674,912	\$ 529,600	\$ 4,204,512
Loss from Operations	(2,545,960)	(356,422)	(2,902,382)
Interest Income	33,838	2,174	36,012
Interest Expense	(65,066)	-	(65,066)
Capital Expenditures	-	(157,315)	(157,315)
Depreciation and Amortization	(80,480)	(77,684)	(158,164)
Total Assets	8,734,832	1,194,438	9,929,270

Six Months Ended June 30, 2009			
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 16,593,827	\$ 287,938	\$ 16,881,765
Income (Loss) from Operations	11,527,109	(596,654)	10,930,455
Interest Income	65,818	5,177	70,995
Interest Expense	(109,866)	-	(109,866)
Capital Expenditures	(12,402)	-	(12,402)
Depreciation and Amortization	(94,749)	-	(94,749)
Total Assets	15,688,468	1,044,337	16,732,805

Three Months Ended June 30, 2010			
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 1,759,127	\$ 446,005	\$ 2,205,132
Income (Loss) from Operations	(1,472,294)	81,596	(1,390,698)
Interest Income	13,996	745	14,741
Interest Expense	(31,687)	-	(31,687)
Capital Expenditures	-	(52,693)	(52,693)
Depreciation and Amortization	(39,756)	(43,180)	(82,936)

Note 9: Segment Data Information (Continued)

	Three Months Ended June 30, 2009		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 11,804,765	\$ 96,388	\$ 11,901,153
Income (Loss) from Operations	8,964,337	(349,539)	8,614,798
Interest Income	45,605	2,511	48,116
Interest Expense	(43,316)	-	(43,316)
Capital Expenditures	(12,402)	-	(12,402)
Depreciation and Amortization	(38,838)	-	(38,838)

Note 10: Subsequent Events

The Company has evaluated these unaudited interim condensed consolidated financial statements for subsequent events through August 12, 2010, the date of issuance of these financial statements.