



DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES

Condensed Consolidated Financial Statements

September 30, 2010

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

	<u>September 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
ASSETS	(Unaudited)	
Current Assets:		
Cash and Cash Equivalents	\$ 5,874,812	\$ 8,419,934
Restricted Cash	304,093	316,129
Accounts Receivable, Net	1,142,939	1,376,034
Inventory, Net	2,935,609	2,820,381
Prepaid Expenses and Other Current Assets	<u>291,367</u>	<u>420,654</u>
Total Current Assets	10,548,820	13,353,132
Fixed Assets, Net	775,086	839,639
Intangible Assets, Net	217,930	148,167
Other Assets	<u>16,929</u>	<u>16,930</u>
	<u>\$ 11,558,765</u>	<u>\$ 14,357,868</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	\$ 1,751,575	\$ 1,949,038
Accrued Expenses	492,856	713,163
Accrued Stockholder Litigation	-	3,250,000
Accrued Interest Payable	66,091	59,838
Note Payable to Stockholder	1,424,941	1,424,941
Income Taxes Payable	<u>168</u>	<u>767</u>
Total Current Liabilities	3,735,631	7,397,747
Convertible Subordinated Debt	<u>4,000,000</u>	<u>-</u>
Total Liabilities	<u>7,735,631</u>	<u>7,397,747</u>
COMMITMENTS AND CONTINGENCIES		
Stockholders' Equity:		
Preferred Stock, \$.0001 Par Value:		
Authorized Shares – 5,000,000; None Issued and Outstanding	-	-
Common Stock, \$.001 Par Value,		
Authorized Shares – 100,000,000; Issued and Outstanding – 31,116,870 and 30,613,995, Respectively	31,117	30,614
Additional Paid-In Capital	76,878,510	76,075,899
Stock to Be Issued	-	23,887
Accumulated Deficit	<u>(73,086,493)</u>	<u>(69,170,279)</u>
	<u>3,823,134</u>	<u>6,960,121</u>
	<u>\$ 11,558,765</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

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue:				
Product Related Revenue, Net	\$ 5,541,489	\$ 4,877,551	\$ 1,922,552	\$ 1,666,587
License Fee Revenue	32,000	10,175,000	-	125,000
Research and Development Revenue	617,695	3,918,561	64,120	297,760
Total Revenue	<u>6,191,184</u>	<u>18,971,112</u>	<u>1,986,672</u>	<u>2,089,347</u>
Cost of Goods Sold:	<u>4,738,392</u>	<u>4,574,353</u>	<u>1,647,413</u>	<u>1,598,567</u>
Gross Profit	<u>1,452,792</u>	<u>14,396,759</u>	<u>339,259</u>	<u>490,780</u>
Expenses:				
General and Administrative	3,740,039	2,475,642	1,105,897	631,263
Sales and Marketing	738,757	723,661	266,161	268,204
Research and Development	920,444	863,311	271,809	238,841
Foreign Currency Exchange Losses (Gains), Net	137,852	51,223	(122,691)	971
Total Expenses	<u>5,537,092</u>	<u>4,113,837</u>	<u>1,521,176</u>	<u>1,139,279</u>
Income (Loss) from Operations	<u>(4,084,300)</u>	<u>10,282,922</u>	<u>(1,181,917)</u>	<u>(648,499)</u>
Other Income (Expense)				
Interest Income	46,003	113,898	9,992	42,903
Interest Expense	(132,657)	(160,189)	(67,591)	(50,323)
Gain on Reduction of Accrued Stockholder Litigation	410,000	-	-	-
Other	(155,260)	1,494	(155,503)	1,494
Total Other Income (Expense)	<u>168,086</u>	<u>(44,797)</u>	<u>(213,102)</u>	<u>(5,926)</u>
Net Income (Loss)	<u>\$ (3,916,214)</u>	<u>\$ 10,238,125</u>	<u>\$ (1,395,019)</u>	<u>\$ (654,425)</u>
Net Income (Loss) per Common Share				
Basic	<u>\$ (0.13)</u>	<u>\$ 0.34</u>	<u>\$ (0.04)</u>	<u>\$ (0.02)</u>
Diluted	<u>\$ (0.13)</u>	<u>\$ 0.31</u>	<u>\$ (0.04)</u>	<u>\$ (0.02)</u>
Weighted Average Common Shares Used in Calculating Net Income (Loss) Per Share:				
Basic	<u>30,971,296</u>	<u>30,042,589</u>	<u>31,063,147</u>	<u>30,119,180</u>
Diluted	<u>30,971,296</u>	<u>32,951,464</u>	<u>31,063,147</u>	<u>30,119,180</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

	Nine Months Ended September 30,	
	2010	2009
	(Unaudited)	(Unaudited)
Operating Activities		
Net Income (Loss)	\$ (3,916,214)	\$ 10,238,125
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided By (Used In) Operating Activities:		
Depreciation and Amortization of Fixed Assets	230,999	219,306
Amortization of Intangible and Other Assets	11,465	10,661
Reduction of Allowance for Doubtful Accounts	(111,399)	-
Reduction of Inventory Reserve	(363,795)	(645,961)
Compensation Expense on Stock Option Grants	668,154	94,568
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	344,493	31,817
Inventory	248,567	1,229,629
Prepaid Expenses and Other Current Assets	129,287	101,407
Other Assets	1	101,999
Accounts Payable	(197,463)	(592,049)
Accrued Expenses	(222,143)	19,257
Accrued Interest Payable to Stockholder	6,253	(143,977)
Accrued Stockholder Litigation	(2,840,000)	-
Deferred Research and Development Obligations	-	(3,207,863)
Income Taxes Payable	1,238	(7,646)
Net Cash Provided By (Used In) Operating Activities	<u>(6,357,557)</u>	<u>7,454,273</u>
Investing Activities		
Purchases of Fixed Assets	(166,446)	(80,361)
Patent Costs	(81,228)	-
Restricted Cash	12,036	(20,124)
Net Cash (Used In) Investing Activities	<u>(235,638)</u>	<u>(100,485)</u>
Financing Activities		
Repayment of Note Payable to Stockholder	-	(1,000,000)
Proceeds from Issuance of Convertible Subordinated Debt	4,000,000	-
Proceeds from Stock Warrant Exercises	16,876	-
Proceeds from Issuance of Common Stock	-	27,083
Proceeds from Stock Option Exercises	31,197	16,050
Net Cash Provided By (Used In) Financing Activities	<u>4,048,073</u>	<u>(956,867)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(2,545,122)	6,396,921
Cash and Cash Equivalents at Beginning of Period	<u>8,419,934</u>	<u>2,826,542</u>
Cash and Cash Equivalents at End of Period	<u>\$ 5,874,812</u>	<u>\$ 9,223,463</u>
Supplemental Cash Flow Information:		
Cash Paid for Interest	<u>\$ 126,404</u>	<u>\$ 304,166</u>

Dyadic International, Inc. and Subsidiaries
Notes to 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 September 30, 2010, 3,056,021 shares of common stock underlying stock options and warrants were not included in computing diluted earnings per share because their effects would be 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 adoption of ASU 2010-17 did not have a material impact on the Company’s consolidated financial statements.

Reclassifications

Certain amounts in the prior year’s 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.

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

Note 2: Inventory (Continued)

Inventory consisted of the following:

	<u>September 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	<u>(Unaudited)</u>	
Finished goods	\$ 3,025,087	\$ 3,147,516
Raw materials	90,522	216,660
	<u>3,115,609</u>	<u>3,364,176</u>
Less reserve for obsolescence	<u>(180,000)</u>	<u>(543,795)</u>
	<u>\$ 2,935,609</u>	<u>\$ 2,820,381</u>

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 \$833,000 and \$3,333,000 for the three and nine months ended September 30, 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. The Codexis License Agreement provides for the payment of \$10,000,000 (the “Codexis Upfront Payment”) provided that certain performance criteria are satisfied by the Company. The Company was also obligated to provide Codexis with information and technical assistance including, but not limited to, access to two full-time equivalent scientists valued at \$500,000, during the first 12 months of the Codexis License Agreement. The 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 \$125,000 and \$9,875,000 during the three and nine months ended September 30, 2009, respectively.

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

Note 3: Significant Agreements (Continued)

Codexis License Agreement (Continued)

Contemporaneously with entering into the Codexis License Agreement, the Company also entered into a Non-Disturbance Agreement (the “Non-Disturbance Agreement”) with the Mark A. Emalfarb Trust under agreement dated October 1, 1987, as amended (the “MAE Trust”), the Francisco Trust under agreement dated February 29, 1996 (the “Francisco Trust”), and Mark A. Emalfarb (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: Convertible Subordinated Debt

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

Approximately \$1,300,000 of the Notes are held by four related party interests which includes members of management and the Board of Directors, as well as another related party.

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

Note 6: Commitments and Contingencies

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 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 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 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 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 settlement of the Class Action Litigation, all pending claims with such insurance carriers with respect to the Emalfarb Arbitration have been released. The Emalfarb 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,

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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Class Action Stockholder Lawsuit (Continued)

based on the alleged failure of the Defendants to disclose in statements to the SEC and to the investing public actual occurrences and risk of financial and operational improprieties by the Company's Asian subsidiaries during the Class Period.

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

On December 22, 2008, Capital Max filed the Second Amended and Consolidated Class Action Complaint (the "Second Amended Complaint"). In January 2009, Defendants Gardner, Berman, Rosengart, Warner and Moor filed motions to dismiss the Second Amended Complaint. On September 29, 2009, the Court dismissed the Section 10(b) count of the Second Amended Complaint with prejudice with respect to Messrs. Berman, Rosengart and Warner, leaving Messrs. Emalfarb, Gardner and Moor as well as the Company to defend against such claim. The Court denied the motions to dismiss by Messrs. Berman, Rosengart, Warner, Gardner and Moor with respect to the Section 20(a) count, leaving those Defendants along with Mr. Emalfarb and the Company to defend against such claim. Both the Company's primary and excess insurance carriers denied coverage for the Class Action Litigation based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies.

On April 16, 2010, the parties to the Class Action Litigation filed a Stipulation of Settlement with the Court which provided for payment to the alleged class of \$4.8 million funded by the Company and its insurance carriers. In consideration for the contribution by the insurance carriers to this 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.

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 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.

Dyadic International, Inc. and Subsidiaries
Notes to Condensed 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 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 by the Court on July 27, 2010 of the Stipulation of Settlement in the Class Action Litigation, this action was dismissed with prejudice on November 4, 2010.

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"), Jenkins & Gilchrist, P.C. and Bilzin Sumberg Baena Price & Axelrod LLP ("Bilzin Sumberg") as well as attorney Robert I. Schwimmer who previously represented the Company while an attorney at Jenkins & Gilchrist P.C. and later at Greenberg Traurig. The Company also named as defendants the law firm of Moscovitz & Moscovitz, P.A. and its attorneys, Norman A. Moscovitz and Jane W. Moscovitz (collectively, the "Moscovitz 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. The Court later granted a similar motion by Ernst & Young Hong Kong. Accordingly, all of the Company's claims against Ernst & Young LLP and Ernst & Young Hong Kong are now in arbitration. A final hearing before the arbitration panel is scheduled for early May 2011.

The Company has received answers and affirmative defenses to the Amended Complaint from all of the defendants in the Circuit Court action. 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 have commenced and are continuing. No trial date has been set.

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

Note 6: Commitments and Contingencies (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 and protracted litigation and/or an unfavorable resolution of any 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: Common Stock

Issuances of Common Stock

The Company issued 231,125 shares of its common stock on various dates during the nine months ended September 30, 2010, based on stock option exercises resulting in total cash proceeds of approximately \$35,700, 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 nine months ended September 30, 2010, based on warrant exercises resulting in 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 nine months ended September 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 8: Share-Based Compensation

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

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

Note 8: Share-Based Compensation (Continued)

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

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 nine months ended September 30, 2010, stock options to purchase 109,875 and 201,125 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 nine months was approximately \$17,200 and \$31,200, respectively. During the three and nine months ended September 30, 2010, stock options to purchase 45,750 shares of common stock at an exercise price of \$0.15 expired. During the three and nine months ended September 30, 2010, stock options to purchase 12,250 shares of common stock at an exercise price of \$0.15 were cancelled. As of September 30, 2010, there were stock options outstanding under the Company's equity plans to purchase 3,117,125 shares of common stock.

The Company recognized non-cash share-based compensation expense for its share-based awards of approximately \$243,000 and \$37,000 for the three months ended September 30, 2010 and 2009, respectively, and approximately \$668,000 and \$95,000 for the nine months ended September 30, 2010 and 2009, respectively. These charges had no impact on the Company's reported cash flows. Total non-cash share-based compensation expense was allocated among the following expense categories:

	Nine Months Ended		Three Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
General and administrative	\$ 514,475	\$ 72,796	\$ 180,600	30,696
Research and development	31,156	8,588	10,475	3,636
Cost of goods sold	49,525	7,003	15,333	2,054
Sales and marketing	72,998	6,181	36,714	156
	<u>\$ 668,154</u>	<u>\$ 94,568</u>	<u>\$ 243,121</u>	<u>\$ 36,542</u>

Note 9: Income Taxes

As of September 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 September 30, 2010.

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

Note 9: Income Taxes (Continued)

The Company is subject to income taxes in the U.S. federal jurisdiction, various state 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 10: Segment Data Information

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

	Nine Months Ended September 30, 2010		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 5,623,483	\$ 567,701	\$ 6,191,184
(Loss) from Operations	(4,045,272)	(39,028)	(4,084,300)
Interest Income	42,183	3,820	46,003
Interest Expense	(132,657)	-	(132,657)
Capital Expenditures	-	(166,446)	(166,446)
Depreciation and Amortization	(120,573)	(121,891)	(242,464)
Total Assets	10,517,874	1,040,891	11,558,765

	Nine Months Ended September 30, 2009		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 18,401,414	\$ 569,698	\$ 18,971,112
Income (Loss) from Operations	10,962,806	(679,884)	10,282,922
Interest Income	106,565	7,333	113,898
Interest Expense	(160,189)	-	(160,189)
Capital Expenditures	(80,361)	-	(80,361)
Depreciation and Amortization	(137,470)	(92,497)	(229,967)
Total Assets	15,844,427	1,014,195	15,875,977

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

Note 10: Segment Data Information (Continued)

	Three Months Ended September 30, 2010		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 1,948,571	\$ 38,101	\$ 1,986,672
Income (Loss) from Operations	(1,499,311)	317,394	(1,181,917)
Interest Income	8,346	1,646	9,992
Interest Expense	(67,591)	-	(67,591)
Capital Expenditures	-	(9,131)	(9,131)
Depreciation and Amortization	(40,093)	(44,207)	(84,300)

	Three Months Ended September 30, 2009		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 1,807,587	\$ 281,760	\$ 2,089,347
(Loss) from Operations	(565,269)	(83,230)	(648,499)
Interest Income	40,747	2,156	42,903
Interest Expense	(50,323)	-	(50,323)
Capital Expenditures	(67,959)	-	(67,959)
Depreciation and Amortization	(42,721)	(92,497)	(135,218)

Note 11: Subsequent Events

The Company has evaluated these unaudited interim condensed consolidated financial statements for subsequent events through November 5, 2010 the date of issuance of these financial statements.