



DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES

Condensed Consolidated Financial Statements

September 30, 2009 and 2008

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
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SEPTEMBER 30, 2009 AND 2008

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DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2009	December 31, 2008
ASSETS	(Unaudited)	
Current Assets:		
Cash and Cash Equivalents	\$ 9,223,463	\$ 2,826,542
Restricted Cash	364,479	344,355
Accounts Receivable, Net	1,472,383	1,504,200
Inventory, Net	3,192,082	3,775,750
Prepaid Expenses and Other Current Assets	<u>535,795</u>	<u>637,202</u>
Total Current Assets	14,788,202	9,088,049
Fixed Assets, Net		
Fixed Assets, Net	900,513	1,039,458
Intangible Assets, Net	151,759	162,420
Other Assets	<u>35,503</u>	<u>137,502</u>
	<u>\$ 15,875,977</u>	<u>\$ 10,427,429</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	\$ 2,086,745	\$ 2,678,794
Accrued Expenses	344,891	325,634
Accrued Interest Payable to Stockholder	50,283	194,260
Deferred Research and Development Obligation	125,000	3,332,863
Note Payable to Stockholder	1,424,941	2,424,941
Income Taxes Payable	<u>1,012</u>	<u>8,658</u>
Total Current Liabilities	<u>4,032,872</u>	<u>8,965,150</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 – 30,181,561 and 29,990,675, Respectively	30,180	29,991
Additional Paid-In Capital	75,986,093	75,843,581
Accumulated Deficit	<u>(64,173,168)</u>	<u>(74,411,293)</u>
	<u>11,843,105</u>	<u>1,462,279</u>
	<u>\$ 15,875,977</u>	<u>\$ 10,427,429</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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue:				
Product Related Revenue, Net	\$ 1,666,587	\$ 2,151,486	\$ 4,877,551	\$ 6,876,841
Research and Development Revenue	422,760	1,061,631	14,093,561	2,976,562
Total Revenue, Net	<u>2,089,347</u>	<u>3,213,117</u>	<u>18,971,112</u>	<u>9,853,403</u>
Cost of Goods Sold	<u>1,483,363</u>	<u>2,079,130</u>	<u>4,235,916</u>	<u>6,828,913</u>
Gross Profit	<u>605,984</u>	<u>1,133,987</u>	<u>14,735,196</u>	<u>3,024,490</u>
Expenses:				
General and Administrative	536,295	2,100,908	2,272,565	8,069,319
Sales and Marketing	285,331	523,009	834,877	2,018,726
Research and Development	431,886	898,218	1,293,609	3,560,314
Foreign Currency Exchange Losses, Net	971	80,837	51,223	17,175
Total Expenses	<u>1,254,483</u>	<u>3,602,972</u>	<u>4,452,274</u>	<u>13,665,534</u>
Income (Loss) from Operations	<u>(648,499)</u>	<u>(2,468,985)</u>	<u>10,282,922</u>	<u>(10,641,044)</u>
Other Income (Expense)				
Interest Income	42,903	10,427	113,898	137,918
Interest Expense	(50,323)	(97,972)	(160,189)	(298,174)
Other	1,494	123	1,494	78,906
Total Other Income (Expense), Net	<u>(5,926)</u>	<u>(87,422)</u>	<u>(44,797)</u>	<u>(81,350)</u>
Net Income (Loss)	<u>\$ (654,425)</u>	<u>\$ (2,556,407)</u>	<u>\$ 10,238,125</u>	<u>\$ (10,722,394)</u>
Net Income (Loss) per Common Share				
Basic	<u>\$ (0.02)</u>	<u>\$ (0.09)</u>	<u>\$ 0.34</u>	<u>\$ (0.36)</u>
Diluted	<u>\$ (0.02)</u>	<u>\$ (0.09)</u>	<u>\$ 0.31</u>	<u>\$ (0.36)</u>
Weighted Average Common Shares Used in Calculating Net Income (Loss) Per Share:				
Basic	<u>30,119,180</u>	<u>29,990,675</u>	<u>30,042,589</u>	<u>29,990,675</u>
Diluted	<u>30,119,180</u>	<u>29,990,675</u>	<u>32,951,464</u>	<u>29,990,675</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,	
	2009	2008
	(Unaudited)	(Unaudited)
Operating Activities		
Net Income (Loss)	\$ 10,238,125	\$ (10,722,394)
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided By (Used in) Operating Activities:		
Depreciation and Amortization of Fixed Assets	219,306	215,474
Amortization of Intangible and Other Assets	10,661	44,932
Amortization of Costs Related to Modification of Notes Payable to Stockholder	-	15,149
Provision for Doubtful Accounts	-	31,000
Reduction of Inventory Reserve	(645,961)	(146,318)
Compensation Expense on Stock Option Grants	94,568	244,111
Common Stock Issued for Rent	5,000	-
Changes in Operating Assets and Liabilities:		
Accounts Receivable	31,817	(30,067)
Inventory	1,229,629	729,818
Prepaid Expenses and Other Current Assets	101,407	(226,750)
Other Assets	101,999	31,784
Accounts Payable	(592,049)	(76,752)
Accrued Expenses	19,257	(1,084,087)
Accrued Interest Payable to Stockholder	(143,977)	108,128
Deferred Research and Development Obligation	(3,207,863)	(2,499,375)
Income Taxes Payable	(7,646)	2,433
Net Cash Provided By (Used In) Operating Activities	<u>7,454,273</u>	<u>(13,362,914)</u>
Investing Activities		
Cost of Patents	-	(51,880)
Purchases of Fixed Assets	(80,361)	(126,539)
Restricted Cash Withdrawal	(20,124)	(14,036)
Net Cash (Used In) Investing Activities	<u>(100,485)</u>	<u>(192,455)</u>
Financing Activities		
Exercise of Stock Options	16,050	-
Issuance of Common Stock	27,083	-
Repayment of Note Payable to Stockholder	(1,000,000)	-
Net Cash (Used In) Financing Activities	<u>(956,867)</u>	<u>-</u>
Net Increase (Decrease) in Cash and Cash Equivalents	6,396,921	(13,555,369)
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>\$ 9,223,463</u>	<u>\$ 2,398,615</u>
Supplemental Cash Flow Information:		
Cash Paid for Interest	<u>\$ 304,166</u>	<u>\$ 190,047</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 generally accepted accounting principles for interim financial reporting. Accordingly, certain information and footnote disclosures normally included in annual 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 intercompany 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, 2008.

Net Income (Loss) Per Common Share

Basic income per share excludes any dilution. It is based upon the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock.

Note 2: 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:

	September 30, 2009	December 31, 2008
	(Unaudited)	
Finished goods	\$ 3,601,078	\$ 4,516,737
Raw materials	331,425	645,395
	3,932,503	5,162,132
Less reserve for obsolescence	(740,421)	(1,386,382)
	\$ 3,192,082	\$ 3,775,750

Note 3: Significant Agreements

Abengoa Agreements

On February 18, 2009, the Company and Abengoa Bioenergy New Technology, Inc. (formerly known as Abengoa Bioenergy R&D, Inc.) (“Abengoa”) mutually agreed to terminate the Abengoa R&D Agreement, entered into a non-exclusive license agreement (the “Abengoa License Agreement”) and mutually agreed to the release of certain claims between the parties in the ABNT Litigation (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 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 \$3,333,000 and \$2,499,000 for the nine months ended September 30, 2009 and 2008, respectively, and approximately \$0 and \$833,000 for the three months ended September 30, 2009 and 2008, respectively. The Company has deferred research and development obligations related to the Abengoa Securities Purchase Agreement, of approximately \$0 and \$3,333,000 at September 30, 2009 and December 31, 2008, respectively (*Note 6*).

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 by Codexis to the Company 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 (“FTE”) 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. The Company received \$0 and \$10 million from Codexis during the three and nine months ended September 30, 2009, respectively. The value of the FTE services that the Company is obligated to provide will be recognized on a straight-line basis over the 12 month service period, retroactive to January 1, 2009, based on the initial delivery of material by Dyadic as stipulated by the terms of the Codexis License Agreement. The remaining portion of the Codexis Upfront Payment was recognized as research and development revenue upon the satisfaction of the performance criteria on April 15, 2009. The Company has recognized research and development 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. At September 30, 2009, the Company had \$125,000 in related deferred research and development obligations.

Note 3: Significant Agreements (Continued)

Strain License Agreement

In April 2009, the Company entered into a non-exclusive license agreement (the “Strain License Agreement”) with a third party company which grants the third party the worldwide right to use two of the Company’s fungal strains (the “Strains”) and know-how for the purposes of testing and evaluating the Strains in laboratory and pilot scale-up activities. Under the Strain License Agreement, the third party paid the Company a non-refundable upfront payment of \$200,000 which was recognized during the nine months ended September 30, 2009 and is included in Research and Development Revenue. The Strain License Agreement provides for an additional payment by the third party to the Company of up to \$200,000 (the “Evaluation Payment”) within ten days of receipt of a confirmation notice from the third party confirming a positive evaluation of the Strains. Upon commercialization of products which incorporate the Strains and for which sales exceed 10,000 Euros, the third party is required to pay the Company an additional payment of \$50,000 (the “Commercialization Payment”) within ten days of such commercialization event. If a positive evaluation of the Strains is not achieved, the third party will return the Strains and the know-how to the Company and no Evaluation Payment or Commercialization Payment shall be due. The total sum potentially payable to the Company amounts to \$450,000.

Note 4: Other Assets

In 2007, the Company paid Polfa Tarchomin S.A. (“Polfa”) a total of approximately 278,000 Euros for the Second Polfa Modification consisting of a prepayment of 173,000 Euros (\$225,000 USD). The Company has discontinued using Polfa as a contract manufacturer. As a result, the Company fully amortized the remaining prepayment of the Polfa modernization costs, amounting to approximately \$140,000 during the nine months ended September 30, 2009. For the three and nine months ended September 30, 2009, the Company amortized approximately \$96,000 and approximately \$140,000, respectively.

Note 5: 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, 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. 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. The Company continues to borrow the outstanding principal amount from the MAE Trust at an interest rate of 14% per annum (*Note 6*).

Note 6: Commitments and Contingencies

Third Party R&D Commitment

On April 24, 2009, the Company and a third party contract research organization (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 made a payment of \$10,000 to the CRO against which future technology transfer services may be deducted.

Note 6: Commitments and Contingencies (Continued)

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. 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 for 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 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 Books and Records Demand

On September 24, 2007, Mark A. Emalfarb, in his capacity as a director of the Company, commenced a legal action against the Company in the Delaware Court of Chancery pursuant to Section 220(d) of the General Corporation Law of the State of Delaware seeking an order of the Court directing the Company to provide to Mr. Emalfarb certain books and records for purposes of inspection and copying to ensure that there had been no waste of the Company’s resources and that there had been no breach of fiduciary duty by the Company’s Board of Directors and/or outside advisors. This action was settled with a settlement stipulation being approved by the Court on February 18, 2008. On May 19, 2009, this action was dismissed with prejudice.

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.

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Mark A. Emalfarb Trust Revolving Note

On October 3, 2007, the Company received a written notice of default from the MAE Trust pursuant to the Revolving Note and the Security Agreement (*Note 4*) 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 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 (*Note 5*).

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 of, 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 Defendant 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. The Company intends to vigorously defend against this Class Action Litigation and is pursuing insurance coverage from its insurance carriers but there can be no assurance that the Company will be successful.

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

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 relates to the Abengoa Securities Purchase Agreement 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, which closed on November 8, 2006. The lawsuit claimed that one or both defendants, among other things, defrauded Abengoa, violated Delaware securities laws, breached the covenant of good faith and fair dealing, and breached the Abengoa Securities Purchase Agreement by making various false and misleading representations that Abengoa relied upon in entering into and closing its purchase of Company shares. Abengoa alleged that the stock it purchased was rendered virtually valueless and unmarketable following the Company's announcements relating to alleged improprieties at its Asian subsidiaries, the extent of the Company's former President and Chief Executive Officer's knowledge of those alleged improprieties and that the annual and quarterly reports filed with the SEC could no longer be relied upon. 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.

Mark A. Emalfarb Annual Meeting Demand

On November 14, 2007, Mark A. Emalfarb, in his capacity as trustee of the MAE Trust, commenced a legal action against the Company in the Delaware Court of Chancery pursuant to Section 211 of the General Corporation Law of the State of Delaware seeking an order of the court directing the Company to call and hold an annual meeting of its stockholders for the election of directors. The parties submitted cross motions for judgment on the pleadings and, following briefing and oral argument, the Court entered an order on April 15, 2008, requiring the Company to hold an annual meeting of stockholders on or before June 20, 2008 to which the Company complied. A Stipulation of Dismissal dismissing the action with prejudice was filed by the parties on May 15, 2009 which was entered by the Court that same day.

Constructive Termination Claims

In May 2008, the Company received notice from all of its executive officers and certain key employees of their resignation from the Company effective on the earlier to occur of June 20, 2008 or the election of directors at the Company's 2008 annual stockholders meeting. In connection with these resignations, five of these individuals have alleged that they have been constructively terminated without cause and thus are entitled to certain severance and other payments under their employment agreements in an aggregate amount of approximately \$480,000. Following their resignations, the Company denied these claims and will vigorously defend against any legal action brought against the Company. Both the Company's primary and excess insurance carriers have denied coverage for these claims based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies.

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

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 \$114,000. 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 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 for the defense of the Class Action Litigation, 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 but there can be no assurance that the Company will be successful.

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 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 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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Professional Liability Lawsuit (Continued)

Amended Complaint contains a claim of civil conspiracy against Ernst & Young LLP, Greenberg Traurig and Mr. Schwimmer. The claims against outside legal counsel are, without limitation, primarily related to the legal consultation 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 LLP and Ernst & Young-Hong Kong.

On September 22, 2009, the Court granted Ernst & Young LLP's motion to compel arbitration and to stay all proceedings between Ernst & Young LLP and the Company. Pursuant to the Circuit Court's Order, an arbitration panel will now decide whether all or some of the Company's claims against Ernst & Young LLP are subject to arbitration or should be returned to the Circuit Court. 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. The Company has received answers and affirmative defenses to the Amended Complaint from Greenberg Traurig, Jenkens & Gilchrist and the Moscowitz Defendants. The Company has replied to avoid the affirmative defenses under the rules of civil procedure. In addition, defendant Bilzin Sumberg has filed a motion to stay the proceedings which was joined by all of the other defendants except Greenberg Traurig and which is scheduled for hearing on November 19, 2009.

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 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: Common Stock

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 stock price.

Note 7: Common Stock (Continued)

Financial Advisor

On September 30, 2009, the Company entered into a Financial Advisory Agreement with a financial advisory firm (the “Advisor”) and in consideration for services to be rendered thereunder, agreed to issue 5,000 shares of the Company’s common stock per month over a period of six months for a total of 30,000 shares of common stock. The Company may, in its sole discretion, issue an additional 20,000 shares of the Company’s common stock to the Advisor at any time. At September 30, 2009, no shares of common stock had been issued.

Note 8: Share-Based Compensation

On February 26, 2009, the Company granted to its employees 629,000 stock options to purchase 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 26, 2019. The fair market value of such stock options was \$0.20 per stock option based on the Black-Scholes valuation model. Assumptions used in the Black-Scholes valuation model for options granted were as follows:

Average Risk-Free Interest Rate	2.98%
Dividend Yield	0.00%
Average Volatility Factor	90.48%
Average Option Life	10 years

During the three and nine months ended September 30, 2009, stock options to purchase 107,000 shares of common stock were exercised at an exercise price of \$0.15 per share. Cash received from stock option exercises during the three and nine months then ended was approximately \$16,000. During the nine months ended September 30, 2009, stock options to purchase 45,000 shares with a weighted average per share exercise price of \$0.15 expired. During the nine months ended September 30, 2009, stock options to purchase 40,750 shares with a weighted average per share exercise price of \$0.15 were cancelled. At September 30, 2009, there were stock options outstanding under the Company’s equity plans to purchase 2,379,750 shares of common stock.

The Company recognized non-cash share-based compensation expense for its share-based awards of approximately \$37,000 and \$82,000 for the three months ended September 30, 2009 and 2008, respectively, and approximately \$95,000 and \$244,000 for the nine months ended September 30, 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:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
General and administrative	\$ 30,696	\$ 44,426	\$ 72,796	\$ 131,830
Research and development	3,636	8,221	8,220	24,394
Cost of goods sold	2,054	12,613	7,003	37,426
Sales and marketing	156	17,004	6,549	50,461
	\$ 36,542	\$ 82,264	\$ 94,568	\$ 244,111

Note 9: Income Taxes

At September 30, 2009, 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, 2009.

The Company is subject to income taxes in the U.S. federal jurisdiction and various states 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 2003. 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, 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)

	Nine Months Ended September 30, 2008		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 9,476,216	\$ 377,187	\$ 9,853,403
Loss from Operations	(9,641,427)	(999,617)	(10,641,044)
Interest Income	125,405	12,513	137,918
Interest Expense	(298,174)	-	(298,174)
Capital Expenditures	(126,539)	-	(126,539)
Depreciation and Amortization	(187,519)	(72,887)	(260,406)

Note 10: Segment Data Information (Continued)

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)

Three Months Ended September 30, 2008			
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 3,084,611	\$ 128,506	\$ 3,213,117
Loss from Operations	(2,188,694)	(280,291)	(2,468,985)
Interest Income	8,748	1,724	10,472
Interest Expense	(97,972)	-	(97,972)
Capital Expenditures	(54,949)	-	(54,949)
Depreciation and Amortization	(41,254)	(50,616)	(91,870)

Note 11: Subsequent Events

The Company has evaluated these unaudited interim condensed consolidated financial statements for subsequent events through November 16, 2009, the date of issuance of these financial statements.