



DYADIC INTERNATIONAL, INC.

Consolidated Financial Statements

December 31, 2008 and 2007

DYADIC INTERNATIONAL, INC.
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DECEMBER 31, 2008 AND 2007

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying balance sheets of Dyadic International, Inc. as of December 31, 2008 and 2007, and the related statements of income, stockholders' equity and cash flows for each of the years in the two-year period ended December 31, 2008. Dyadic International, Inc.'s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Dyadic International, Inc. as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

/s/ Goldstein Lewin & Co.

GOLDSTEIN LEWIN & CO.
Certified Public Accountants
Boca Raton, Florida
October 26, 2009

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Current Assets:		
Cash and Cash Equivalents	\$ 2,826,542	\$ 15,953,984
Restricted Cash	344,355	349,193
Accounts Receivable, Net	1,504,200	1,411,070
Inventory, Net	3,775,750	6,122,758
Prepaid Expenses and Other Current Assets	<u>637,202</u>	<u>794,318</u>
Total Current Assets	9,088,049	24,631,323
Fixed Assets, Net	1,039,458	1,186,617
Intangible Assets, Net	162,420	90,337
Other Assets	<u>137,502</u>	<u>182,409</u>
	<u>\$ 10,427,429</u>	<u>\$ 26,090,686</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	\$ 2,678,794	\$ 1,941,754
Accrued Expenses	325,634	1,521,174
Accrued Interest Payable to Stockholder	194,260	48,896
Deferred Research and Development Obligation	3,332,863	3,332,500
Note Payable to Stockholder	2,424,941	2,404,742
Income Taxes Payable	<u>8,658</u>	<u>6,456</u>
Total Current Liabilities	8,965,150	9,255,522
Long-Term Liabilities:		
Deferred Research and Development Obligation	<u>-</u>	<u>3,332,863</u>
	<u>8,965,150</u>	<u>12,588,385</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 – 29,990,675	29,991	29,991
Additional Paid-In Capital	75,843,581	75,517,205
Accumulated Deficit	<u>(74,411,293)</u>	<u>(62,044,895)</u>
	<u>1,462,279</u>	<u>13,502,301</u>
	<u>\$ 10,427,429</u>	<u>\$ 26,090,686</u>

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

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
Revenue:		
Product Related Revenue, Net	\$ 9,156,529	\$ 9,676,581
Research and Development Revenue	3,958,546	3,603,373
	<u>13,115,075</u>	<u>13,279,954</u>
Total Revenue, Net		
Cost of Goods Sold:	<u>9,112,945</u>	<u>8,521,251</u>
Gross Profit	<u>4,002,130</u>	<u>4,758,703</u>
Expenses:		
General and Administrative	9,733,989	8,247,588
Sales and Marketing	2,344,736	3,381,430
Research and Development	4,102,516	5,008,615
Foreign Currency Exchange Losses, Net	24,153	23,947
Impairment Loss	-	3,993,276
	<u>16,205,394</u>	<u>20,654,856</u>
Total Expenses		
Loss from Operations	<u>(12,203,264)</u>	<u>(15,896,153)</u>
Other Income (Expense)		
Interest Income	145,765	1,092,778
Interest Expense	(388,980)	(272,252)
Liquidated Damages	-	(1,103,906)
Gain on Sale of Land	-	200,000
Gain on Reversal of Related Party Payable	-	475,393
Other	80,081	120
	<u>(163,134)</u>	<u>392,133</u>
Total Other Income (Expense), Net		
Net Loss	<u>\$ (12,366,398)</u>	<u>\$ (15,504,020)</u>
Basic and Diluted Net Loss Per Common Share	<u>\$ (0.41)</u>	<u>\$ (0.52)</u>
Weighted Average Common Shares Used in Calculating Net Loss Per Share:		
Basic and Diluted	<u>29,990,675</u>	<u>29,961,563</u>

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

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

	<u>Common Stock</u>		<u>Additional Paid In Capital</u>	<u>Stock Option Exercise</u>	<u>Accumulated Deficit Total</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Balance at December 31, 2006	29,792,992	\$ 29,793	\$ 74,501,592	\$ (19,313)	\$ (46,540,875)	\$ 27,971,197
Amortization of Deferred Compensation on Employee and Nonemployee Stock Options	-	-	(109,172)	-	-	(109,172)
Issuance of Stock for Consulting Services	87,125	87	643,460	-	-	643,547
Issuance of Stock for Stock Option Exercises	53,050	53	165,089	19,313	-	184,455
Issuance of Stock for Warrant Exercises	57,508	58	316,236	-	-	316,294
Net Loss	-	-	-	-	(15,504,020)	(15,504,020)
Balance at December 31, 2007	<u>29,990,675</u>	<u>29,991</u>	<u>75,517,205</u>	<u>-</u>	<u>(62,044,895)</u>	<u>13,502,301</u>
Amortization of Deferred Compensation on Employee and Nonemployee Stock Options	-	-	326,376	-	-	326,376
Net Loss	-	-	-	-	(12,366,398)	(12,366,398)
Balance at December 31, 2008	<u><u>29,990,675</u></u>	<u><u>\$ 29,991</u></u>	<u><u>\$ 75,843,581</u></u>	<u><u>\$ -</u></u>	<u><u>\$ (74,411,293)</u></u>	<u><u>\$ 1,462,279</u></u>

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
Operating Activities		
Net Loss	\$ (12,366,398)	\$ (15,504,020)
Adjustments to Reconcile Net Loss to Net Cash (Used In) Operating Activities:		
Depreciation and Amortization of Fixed Assets	286,656	217,100
Amortization of Intangible and Other Assets	51,722	52,941
Amortization of Costs Related to Modification of Notes Payable to		
Stockholder	20,200	25,910
Provision (Recovery) for Doubtful Accounts	255,000	(2,000)
Inventory Reserve	226,712	578,579
Gain on Sale of Land	-	(200,000)
Compensation Expense on Stock Option Grants	326,376	(109,172)
Stock Issued for Consulting Services	-	643,547
Impairment Loss	-	3,993,276
Changes in Operating Assets and Liabilities:		
Accounts Receivable	(348,129)	(356,995)
Inventory	2,120,296	(1,380,172)
Prepaid Expenses and Other Current Assets	157,116	15,954
Other Assets	44,907	(33,250)
Accounts Payable	737,040	340,868
Accrued Expenses	(1,194,489)	47,998
Accrued Interest Payable to Stockholder	145,364	-
Deferred Research and Development Obligation	(3,332,500)	(3,332,500)
Income Taxes Payable	2,202	(17,501)
Other Liabilities	-	(89,877)
Net Cash (Used In) Operating Activities	<u>(12,867,925)</u>	<u>(15,109,314)</u>
Investing Activities		
Cost of Patents	(123,805)	(47,231)
Purchases of Fixed Assets	(140,550)	(794,443)
Proceeds from Sale of Land	-	1,200,000
Restricted Cash (Withdrawal) Deposit	4,838	(349,193)
Net Cash (Used In) Provided By Investing Activities	<u>(259,517)</u>	<u>9,133</u>
Financing Activities		
Proceeds from Stock Warrant Exercises	-	316,294
Proceeds from Stock Option Exercises	-	184,455
Net Cash Provided by Financing Activities	<u>-</u>	<u>500,749</u>
Net Decrease in Cash and Cash Equivalents From Continuing Operations	(13,127,442)	(14,599,432)
Cash and Cash Equivalents at Beginning of Period	<u>15,953,984</u>	<u>30,553,416</u>
Cash and Cash Equivalents at End of Period	<u>\$ 2,826,542</u>	<u>\$ 15,953,984</u>
Supplemental Cash Flow Information:		
Cash Paid for Interest	<u>\$ 359,735</u>	<u>\$ 237,119</u>
Cash Paid for Income Tax	<u>\$ -</u>	<u>\$ 4,500</u>

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

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

Note 1: Organization and Operations

General

Dyadic International, Inc. (the “Company” or “Dyadic”) is an early-stage biotechnology company headquartered in Jupiter, Florida with operations in the United States (“U.S.”), the Netherlands and Poland (*Note 6*). Dyadic has approximately 35 full-time employees, 20 of which are dedicated to research and development (“R&D”) activities at the Company’s laboratories in Florida, North Carolina and the Netherlands.

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

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

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

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

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

The Company’s current patent portfolio consists of five U.S. and 53 foreign patents, nine pending U.S. and 31 pending foreign patent applications as well as numerous U.S. and foreign publications, including, but not limited to, ten international patent cooperation treaty (PCT) publications. The Company, as it deems appropriate based on a cost-benefit analysis, may periodically decide to abandon or forego pursuing certain patent applications. In addition, the Company has developed an extensive body of

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

Note 1: Organization and Operations (Continued)

General (Continued)

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

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

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

Organizational History

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

In October 2004, CCP Worldwide entered into an Agreement of Merger and Plan of Reorganization with Dyadic-Florida, a then privately-held Florida corporation which was incorporated in 1979 (formerly known as Dyadic International, Inc.) and CCP Acquisition Corp., a wholly owned subsidiary of CCP Worldwide (the "Merger") whereby CCP Acquisition Corp. was merged with and into Dyadic-Florida. As a result of the Merger and in exchange for all of the outstanding shares of Dyadic-Florida, shareholders of Dyadic-Florida received shares of CCP Worldwide on a one-for-one basis which resulted in Dyadic-Florida becoming a wholly owned subsidiary of CCP Worldwide. CCP Worldwide then changed its name to Dyadic International, Inc. and Dyadic-Florida changed its name to Dyadic International (USA), Inc. For financial accounting purposes, the Merger was treated as an acquisition by Dyadic-Florida of CCP Worldwide.

In 1998, Geneva purchased a majority equity interest in Puridet (Asia) Limited, a company organized under the laws of Hong Kong ("Puridet"), which became a voting majority interest and a subsidiary for reporting purposes in 2003. In April 2006, Geneva purchased the remaining minority interest to become a 100% owner of Puridet. In April 2007, following the discovery of alleged improprieties at Puridet and its wholly owned subsidiary, Dongguan Puridet Softner Limited, a company organized under the laws of China, the Company announced that it was abandoning its Asian operations (*Note 3*).

In April 2001, Dyadic-Florida formed Dyadic-Poland for the purpose of managing and coordinating the Company's contract manufacturing of industrial enzymes in Poland and to assist in the marketing and distribution of those products.

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

Note 1: Organization and Operations (Continued)

Organizational History (Continued)

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

In May 2005, the Company formed Dyadic Real Estate Holdings, Inc., a Florida corporation (“DREH”) and wholly owned subsidiary, to which it assigned a contract relating to an undeveloped parcel of land purchased by the Company in Jupiter, Florida (*Note 6*). Following the sale of this land by DREH in July 2007, DREH was dissolved in January 2008.

Historical Results of Operations

The Company has incurred losses from operations during the last several years, which have resulted in an accumulated deficit of approximately \$74,411,000 and \$62,045,000 as of December 31, 2008 and 2007, respectively. The Company attributes the majority of these operating results to discretionary R&D expenditures to improve the C1 Platform Technology and other proprietary technologies as well as significantly increased legal and other costs associated with the discovery of alleged improprieties at the Company’s Asian subsidiaries in April 2007 and subsequent related events (*Note 3*). Operating losses have also been the result of the expansion of the Company’s operations and administrative support staff as a public company engaged in enzyme biotech research, and its increased sales and marketing spending to introduce new products to the marketplace. In order to advance its science and to develop new products, the Company has continued to incur discretionary R&D expenditures which the Company believes will continue in 2009 and beyond.

During the second half of 2007, the Company reduced its employee base and began the streamlining of its R&D efforts by closing its laboratory in Davis, California and consolidating it into its Jupiter, Florida laboratory. In November 2007, the Company adopted a retention bonus plan for its non-management employees with maximum aggregate bonuses payable of \$450,000 and a Change of Control Transaction Bonus Plan for its executive and management employees with maximum aggregate bonuses payable of \$625,000. The purpose of these plans was to help retain and incentivize the Company’s employees in order to prevent disruption to the Company from a potential loss of personnel or reduced commitment by employees while the Company continued operations and pursued the Strategic Process (as defined below) in the aftermath of discovering alleged improprieties at its Asian subsidiaries (*Notes 3 and 7*). During the years ended December 31, 2008 and 2007, \$187,000 and \$90,000, respectively, were expensed, of which \$90,000 was accrued at December 31, 2007.

The Company believes that at December 31, 2008, it had and currently has sufficient capital to fund its operations and meet its obligations for the next twelve months and beyond. The Company has established a number of flexible contractual relationships in the areas of manufacturing and R&D. This enables the Company to adjust its spending in those areas, as necessary, in order to achieve the objectives of its business plan while also managing its resources and cash utilization rate. In June 2008, the Company experienced a dramatic reduction in its executive management (*Note 3*) and subsequently implemented other cost saving measures. The Company has historically funded net losses from operations with proceeds from product revenues, external borrowings, borrowings from its stockholders, collaborations with third parties, licensing or selling certain of its technologies, exercises and conversions of equity instruments, and sales of preferred and common equity securities. Additional funds may be needed and raised through public or private debt and/or equity financings, collaborative relationships, licensing or selling of certain technologies, sales of enzymes, government grants or other arrangements. If sought, additional funding may not be available or may not be available on terms and conditions

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

Note 2: Summary of Significant Accounting Policies

Historical Results of Operations (Continued)

acceptable to the Company. Similarly, any additional financing may be dilutive to stockholders, and debt financing, if available, may involve restrictive covenants. Failure to successfully raise funds when needed may harm the Company's operations, financial condition and cash flows.

Principles of Consolidation

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

Use of Estimates

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

Cash and Cash Equivalents

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

Restricted Cash

The Company had restricted cash of approximately \$344,000 and \$349,000 at December 31, 2008 and 2007, respectively, which is reserved for the build-out of the Company's laboratory in the Netherlands (*Note 6*).

Accounts Receivable

Accounts receivable are recorded at their net realizable value on the date revenue is recognized. The Company provides allowances for doubtful accounts for estimated losses resulting from the inability of its customers to repay their obligations. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to repay, additional allowances may be required. The Company provides for potential uncollectible accounts receivable based on specific customer identification and historical collection experience adjusted for existing market conditions. If market conditions decline or its customers experience economic difficulties, actual collection experience may not meet expectations and may result in decreased cash flows and increased bad debt expense.

The policy for determining past due status is based on the contractual payment terms of each customer, which are generally net 30, 60 or 90 days. Once collection efforts by the Company and its collection agency are exhausted, the determination for charging off uncollectible receivables is made.

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

Note 2: Summary of Significant Accounting Policies (Continued)

Accounts Receivable (Continued)

Accounts receivable consisted of the following at December 31:

	2008	2007
Accounts receivable	\$ 1,774,200	\$ 1,428,071
Less: Allowance for doubtful accounts	(270,000)	(17,000)
	\$ 1,504,200	\$ 1,411,071

Credit Risk

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

Inventory

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

Inventory consisted of the following at December 31:

	2008	2007
Finished goods	\$ 4,516,737	\$ 6,141,338
Raw materials	645,395	1,141,090
	5,162,132	7,282,428
Less reserve for obsolescence	(1,386,382)	(1,159,670)
	\$ 3,775,750	\$ 6,122,758

Fixed Assets

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

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

Note 2: Summary of Significant Accounting Policies (Continued)

Fixed Assets (Continued)

Fixed assets consisted of the following at December 31:

	<u>Estimated Useful Life (Years)</u>	<u>2008</u>	<u>2007</u>
Lab and manufacturing equipment	3 – 10	\$ 2,868,106	\$ 2,736,390
Furniture and fixtures	3 – 7	290,043	300,617
Leasehold improvements	5	93,278	90,502
Vehicles	4 - 5	17,084	17,084
		<u>3,268,510</u>	<u>3,144,593</u>
Less accumulated depreciation and amortization		<u>(2,229,053)</u>	<u>(1,957,976)</u>
		<u>\$ 1,039,458</u>	<u>\$ 1,186,617</u>

Depreciation and amortization expense of fixed assets for the years ended December 31, 2008 and 2007 was approximately \$287,000 and \$217,000, respectively, of which approximately \$120,000 and \$69,000, respectively, was included in cost of goods sold and approximately \$167,000 and \$148,000, respectively, was included in general and administrative costs in the accompanying consolidated statements of operations.

Intangible Assets

Intangible assets include patent and technology acquisition costs which are being amortized using the straight-line method over the estimated useful lives of the patents, determined to be twelve years. Approximately \$124,000 in 2008 and \$47,000 in 2007 related to the patents and technology were capitalized. Amortization expense was approximately \$52,000 and \$53,000, respectively, for the years ended December 31, 2008 and 2007.

Intangible assets consisted of the following at December 31:

	<u>2008</u>	<u>2007</u>
Patents	\$ 712,394	\$ 588,589
Less: Accumulated amortization	<u>(549,974)</u>	<u>(498,252)</u>
	<u>\$ 162,420</u>	<u>\$ 90,337</u>

Long-Lived Assets

The Company reviews its long-lived assets for impairment, including fixed assets that are held and used in its operations, whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable, as required by Statement of Financial Accounting Standards (“SFAS”) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. If such an event or change in circumstances occurs, the Company will estimate the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the undiscounted future cash flows is less than the carrying amount of the related assets, the Company will recognize an

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

Note 2: Summary of Significant Accounting Policies (Continued)

Long-Lived Assets (Continued)

impairment loss if the carrying value exceeds the fair value. Assets to be disposed of are reclassified as assets held for sale at the lower of their carrying amount or fair value less costs to sell. Write-downs to fair value less disposal costs are reported as a part of loss from operations.

The Company does not believe that there were any events or changes in circumstances which indicate that the carrying amounts of its long-lived assets may not be recoverable as of December 31, 2008 and 2007, respectively, other than the events set forth in *Note 3* hereof.

Accrued Expenses

Accrued expenses consisted of the following at December 31:

	2008	2007
Accrued wages and benefits	\$ 37,070	\$ 299,812
Accrued expenses relating to vendors and others	288,564	902,471
Accrued liquidated damages	-	224,300
Research and development	-	94,591
	\$ 325,634	\$ 1,521,174

Fair Value of Financial Instruments

In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 157, *Fair Value Measurements* (“SFAS No. 157”). SFAS No. 157 does not expand the use of fair value measures in financial statements, but standardizes its definition and guidance by defining fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value and expands disclosure related to the use of fair value measures. In February 2008, the FASB issued FASB Staff Position (“FSP”) Financial Accounting Standard 157-2, *Effective Date of FASB Statement No. 157* (“FSP FAS 157-2”), which provides a one-year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities to years beginning after November 15, 2008, except those that are recognized or disclosed in the financial statements at fair value at least annually. SFAS No. 157 was effective for the Company’s fiscal year beginning January 1, 2008, excluding the effect of the deferral granted in FSP FAS 157-2. The Company is currently evaluating the impact of adopting SFAS No. 157 with respect to non-financial assets and non-financial liabilities on the Company’s financial statements, which will be effective beginning January 1, 2009.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (“SFAS No. 159”). Under SFAS No. 159, the Company may elect to report most financial instruments and certain other items at fair value on an instrument-by-instrument basis with changes in fair value reported in earnings. After the initial adoption, the election is made at the acquisition of an eligible financial asset, financial liability, or firm commitment or when certain specified reconsideration events occur. The fair value election may not be revoked once an election is made. SFAS No. 159 was effective for the Company’s fiscal year beginning January 1, 2008, however, the Company has elected not to measure eligible financial assets and liabilities at fair value. Accordingly, SFAS No. 159 did not have an impact on the Company’s financial statements.

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

Note 2: Summary of Significant Accounting Policies (Continued)

Fair Value of Financial Instruments (Continued)

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and the note payable to stockholder approximate fair value due to the short maturities of the instruments.

Under SFAS No. 157, fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The Company has determined that there was no material difference between the carrying value and the fair value of its financial assets and liabilities as of December 31, 2008 and therefore no adjustment for the effect of SFAS No. 157 was made to the Company's consolidated financial statements as of December 31, 2008.

Revenue Recognition

The Company recognizes revenues in accordance with the U.S. Securities and Exchange Commission ("SEC") Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements* ("SAB 104"). Under SAB 104, revenue is recognized when (1) persuasive evidence of an arrangement exists; (2) services have been rendered or product has been delivered; (3) price to the customer is fixed and determinable; and (4) collection of the underlying receivable is reasonably assured. Revenues not meeting any of the aforementioned criteria are deferred.

Product Revenue

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

Collaborative Revenue

Revenues under the Abengoa R&D Agreement (as defined below)(*Note 4*) are recognized in accordance with SAB 104 and Emerging Issues Task Force ("EITF") Issue No. 99-19, *Reporting Gross Revenue as a Principal vs. Net as an Agent* ("EITF Issue No. 99-19"). According to the criteria established by EITF Issue No. 99-19, the Company is the primary obligor of the agreement because it is responsible for the selection, negotiation, contracting and payment of the third party suppliers. R&D revenues are recognized, on a gross basis, as activities are performed under the terms of the related agreement. As of December 31, 2008 and 2007, respectively, the Company had approximately \$3,333,000 and \$6,665,000 in deferred R&D obligations related to the Abengoa R&D Agreement. These

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

Note 2: Summary of Significant Accounting Policies (Continued)

Collaborative Revenue (Continued)

amounts are being recognized as revenue as the expenses associated with the R&D program contemplated under the Abengoa R&D Agreement are incurred.

License Revenue

Revenues under the Codexis License Agreement (as defined below) (*Note 4*) are recognized in accordance with SAB 104. The Company defers upfront and milestone payments received and recognizes revenue as products are delivered, services are rendered ratably over the requisite service periods and/or performance criteria as set forth in the Codexis License Agreement are met.

Research and Development

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

R&D costs incurred by type of project during the years ended December 31, 2008 and 2007, respectively, were as follows:

	<u>2008</u>	<u>2007</u>
Internal R&D	\$ 1,741,402	\$ 1,248,842
Collaborations with third parties	<u>2,361,114</u>	<u>3,759,773</u>
	<u>\$ 4,102,516</u>	<u>\$ 5,008,615</u>

R&D expense based upon type of cost incurred during the years ended December 31, 2008 and 2007, respectively, were as follows:

	<u>2008</u>	<u>2007</u>
Personnel related	\$ 1,018,641	\$ (113,735)
Laboratory and supplies	245,194	172,882
Outside services	2,361,114	3,759,773
Facilities, overhead and other	<u>477,567</u>	<u>1,189,695</u>
	<u>\$ 4,102,516</u>	<u>\$ 5,008,615</u>

The Company recognized approximately \$3,959,000 and \$3,603,000 in R&D revenue for the years ended December 31, 2008 and 2007, respectively, which is included in research and development revenue in the accompanying consolidated statements of operations.

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

Note 2: Summary of Significant Accounting Policies (Continued)

Advertising Costs

Advertising costs are expensed as incurred. During the years ended December 31, 2008 and 2007, respectively, advertising costs incurred by the Company totaled approximately \$15,000 and \$23,000, respectively, and are included in sales and marketing expenses in the accompanying consolidated statements of operations.

Registration Payment Arrangements

The Company accounts for registration payment arrangements under FASB Staff Position (“FSP”) EITF 00-19-2, *Accounting for Registration Payment Arrangements* (“FSP EITF 00-19-2”). FSP EITF 00-19-2 specifies that the contingent obligation to make future payments under a registration payment arrangement should be separately recognized and measured in accordance with SFAS No. 5, *Accounting for Contingencies*. FSP EITF 00-19-2 was issued in December 2006. Early adoption of FSP EITF 00-19-2 is permitted and the Company adopted FSP EITF 00-19-2 effective January 3, 2007. For the year ended December 31, 2007, the Company recorded liquidated damages in the amount of approximately \$1,104,000. At December 31, 2008 and 2007, the accrued liquidated damages were \$0 and \$224,300, respectively.

Foreign Currency Translation

The financial statements of the Company's foreign subsidiaries have been translated into U.S. dollars in accordance with SFAS No. 52, *Foreign Currency Translation*. Assets and liabilities of the Company's foreign subsidiaries are translated at period-end exchange rates, and revenues and expenses are translated at average rates prevailing during the period. Certain accounts receivable from customers are collected and certain accounts payable to vendors are payable in currencies other than the functional currencies of the Company and its subsidiaries. These amounts are adjusted to reflect period-end exchange rates.

Share-based Compensation

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

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. (“EITF Issue No. 96-18”). Under EITF Issue No. 96-18, the fair value of the equity instrument is calculated using the Black-Scholes valuation model at each reporting period with charges amortized to the results of operations over the instrument’s vesting period.

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

Note 2: Summary of Significant Accounting Policies (Continued)

Income Taxes

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

In June 2006, the FASB issued FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty on Income Taxes* ("FIN No. 48"), which clarifies SFAS No. 109, *Accounting for Income Taxes* by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted FIN No. 48 as of the beginning of its fiscal year beginning January 1, 2007. However, as of the date of such adoption and as of December 31, 2008 and 2007, the Company has not taken, nor recognized the financial statement impact of, any material tax positions, as defined by FIN No. 48. The Company's policy is to recognize as non-operating expense interest and penalties related to income tax matters at the time such payments become probable, although it had not recognized any such items in its statement of operations for the years ended December 31, 2008 or 2007. The tax years ending December 31, 2005 and thereafter remain subject to examination by Federal and state tax jurisdictions.

Net Loss Per Share

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

The following potentially dilutive securities were not included in the calculation of diluted net loss per share as they were anti-dilutive, based on common stock prices of \$0.15 and \$5.30 per share at December 31, 2008 and 2007, respectively, for the respective periods presented:

	2008	2007
Instruments to purchase common stock:		
Stock options outstanding	-	1,315,806
Warrants outstanding (<i>Note 8</i>)	-	1,583,610
	-	2,899,416
Total shares of common stock considered anti-dilutive	-	2,899,416

There were contingently issuable shares under the Development Agreement (as defined below) for the performance of R&D activities by the CRO (as defined below) on behalf of the Company (*Note 6*), of which approximately 87,000 and 293,000 are also excluded from the calculation of net loss per share for the years ended December 31, 2008 and 2007, respectively. Such shares of common stock are unearned, non-vested or restricted shares that will be considered outstanding once earned under the Development Agreement.

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

Note 2: Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements

In June 2007, the FASB ratified a consensus opinion reached by the EITF on EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* (“EITF Issue No. 07-3”). The guidance in EITF Issue No. 07-3 requires the Company to defer and capitalize non-refundable advance payments made for goods or services to be used in R&D activities until the goods have been delivered or the related services have been performed. If the goods are no longer expected to be delivered nor the services expected to be performed, the Company would be required to expense the related capitalized advance payments. The consensus in EITF Issue No. 07-3 was effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2007 and is applied prospectively to new contracts entered into on or after December 15, 2007. The Company adopted EITF Issue No. 07-3 effective January 1, 2008 which did not have a material impact on the Company’s results of operations or financial condition.

In December 2007, the FASB ratified EITF Issue No. 07-1, *Accounting for Collaborative Arrangements* (“EITF Issue No. 07-1”). EITF Issue No. 07-1 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF Issue No. 07-1 also establishes the appropriate income statement presentation and classification for joint operating activities and payments between participants, as well as the sufficiency of the disclosures related to these arrangements. EITF Issue No. 07-1 is effective for fiscal years beginning after December 15, 2008, and shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. The Company is currently assessing the potential impact, if any, the adoption of EITF Issue No. 07-1 may have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141, revised, *Business Combinations* (“SFAS No. 141(R)”), which replaces SFAS No. 141. The statement retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in the purchase accounting. It also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process R&D at fair value and requires the expensing of acquisition-related costs as incurred. SFAS No. 141(R) is effective in fiscal years beginning after December 15, 2008. The Company will assess the potential impact of the adoption of SFAS 141(R) if, and when, a future acquisition occurs.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements — an amendment of Accounting Research Bulletin No. 51*, (“SFAS No. 160”). SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company currently has no minority interests and accordingly the adoption of SFAS No. 160 is not expected to have a material impact on its consolidated financial statements. However, SFAS No. 160 may have an impact on any acquisitions the Company consummates after January 1, 2009

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

Note 2: Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

In April 2008, the FASB issued FSP No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* ("FSP No. 142-3"). FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*, and also requires expanded disclosure related to the determination of intangible asset useful lives. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the potential impact, if any, the adoption of FSP No. 142-3 may have on the Company's consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ("SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles to be used in the preparation of financial statements that are presented in conformity with GAAP for non-governmental entities. SFAS No. 162 became effective November 15, 2008.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* ("SFAS 165"). SFAS 165 incorporates existing guidance into the accounting literature for the accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued. In addition, the standard requires disclosure of the date through which a company has evaluated subsequent events. SFAS 165 will be effective as of the end of the Company's fiscal year 2009.

In June 2008, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, ("SFAS No. 167"). SFAS No. 167 is a revision to FIN No. 46(R), *Consolidation of Variable Interest Entities* ("FIN No. 46(R)"), and amends the consolidation guidance for variable interest entities under FIN No. 46(R). SFAS No. 167 is effective for fiscal years beginning after November 15, 2009. The Company is currently evaluating the impact, if any, of the adoption of SFAS No. 167 on its consolidated financial statements.

In July 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles* ("SFAS No. 168"), which replaces SFAS No. 162. SFAS No. 168 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP in the U.S. (the GAAP hierarchy), and will become effective for interim and annual periods ending after September 15, 2009.

Note 3: Significant Events

Abandonment of Asian Operations

In April 2007, the Company became aware of alleged improprieties at its Asian subsidiaries after receiving anonymous whistleblower communications that alleged numerous improprieties perpetrated against the Asian subsidiaries by its management.

The audit committee (the "Audit Committee") of the Company's Board, after consultation with its outside legal counsel, engaged a separate law firm to conduct an investigation of the facts surrounding these alleged events. The investigation revealed, among other things, that the largest customer of the Asian subsidiaries was secretly controlled by the management of the Asian subsidiaries. This customer

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

Note 3: Significant Events (Continued)

Abandonment of Asian Operations (Continued)

purchased products from the Asian subsidiaries and re-sold them to businesses in mainland China for the alleged purpose of allowing these businesses to avoid Chinese tax requirements.

As a result of these discoveries and the Company's inability to obtain reliable financial or other information from the Asian subsidiaries, after consultation with its outside legal counsel, the Company announced its decision to abandon its Asian subsidiaries in May 2007. The Company is required to measure the gain or loss on abandonment as of the abandonment date. The Company is currently unable to do so because it does not have, and believes it is unable to obtain, reliable financial information from its Asian subsidiaries that is necessary to perform audits and produce the resulting financial statements for the periods from January 2007 through May 2007. As a result, the Company has determined the abandonment date to be January 1, 2007 for accounting purposes. Based on the abandonment, the rights and obligations of future cash flows resulting from the operations of the Asian subsidiaries are not those of the Company. Accordingly, the net assets of the Asian subsidiaries have been fully impaired and adjusted for the impact of the Asian subsidiaries in the previous years' accumulated deficit.

The components of the impairment loss are as follows:

Puridet Assets	\$ 3,421,048
Goodwill	1,808,458
Liabilities	<u>(1,236,230)</u>
	<u>\$ 3,993,276</u>

The Company has received a legal opinion from its outside legal counsel indicating that potential liability to the Company stemming from potential liability incurred by its abandoned Asian subsidiaries is remote and in all events likely to be immaterial to the Company's results of operations.

SEC Filings and Reporting

On April 23, 2007, following the discovery of alleged improprieties at the Company's Asian subsidiaries, the Board, upon the recommendation of the Audit Committee, after consultation with its outside legal counsel and auditors, announced that the Company's previously filed financial statements, including those contained in its Annual Reports on Form 10-KSB ("Annual Reports") and Quarterly Reports on Form 10-QSB ("Quarterly Reports"), as filed with the SEC, should no longer be relied upon. The Company was subsequently not able to make timely filings with the SEC of its Quarterly Reports or its Annual Report, nor has it been in a position to announce its operational and financial results for those periods.

The Company, after consultation with its outside legal counsel, also suspended indefinitely the use of its previously filed registration statement on Form S-3 covering the resale of shares of its common stock by investors who participated in the PIPE Transaction (as defined below) (Note 7). The Company had discussions and voluntarily shared the foregoing and other information and documents with the SEC (Note 6).

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

Note 3: Significant Events (Continued)

American Stock Exchange (“AMEX”) Delisting; Resumption of Trading

On April 23, 2007, following the determination by the Board, after consultation with its outside legal counsel, that the Company’s previously filed financial statements, including those contained in its Annual Reports and Quarterly Reports as filed with the SEC, should no longer be relied upon, the Company requested the AMEX to halt trading in the Company’s common stock.

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

As a result of the Company’s continued non-compliance with the AMEX listing standards for (i) failure to timely file its Quarterly Reports for the periods ended March 31, 2007, June 30, 2007 and September 30, 2007, and (ii) failure to hold an annual meeting of its stockholders in 2007 to elect directors and to take other appropriate corporate action, the Company’s common stock was not able to resume trading on the AMEX. On January 30, 2008, the AMEX filed a Form 25 with the SEC to remove the Company’s common stock from listing on the AMEX and to withdraw the registration of the Company’s common stock under Section 12(b) of the Securities Exchange Act of 1934 (the “1934 Act”). The AMEX delisting took effect on February 11, 2008 and the withdrawal of registration under Section 12(b) took effect on April 29, 2008. As a result, the Company became a non-reporting issuer and is currently not required to file reports with the SEC under Section 13 or 15(d) of the 1934 Act. The Company currently has no timetable for when, or if, it may resume being an SEC reporting company.

Management Changes

On April 23, 2007, upon the recommendation of the Audit Committee of the Board based on its consultation with outside legal counsel, the Company’s President, Chief Executive Officer and Chairman of the Board, Mark A. Emalfarb, took a voluntary leave of absence from his positions and offices with the Company, pending the completion of the investigation by an outside law firm engaged by the Audit Committee into the alleged improprieties at the Company’s Asian subsidiaries. Mr. Emalfarb remained a director of the Company.

On September 20, 2007, the special committee of the Board (the “Special Committee”), acting upon the recommendation of the Audit Committee based on its consultation with outside legal counsel, authorized the Company to terminate the employment of Mr. Emalfarb for “cause” as the Company’s Chief Executive Officer and President (*Note 6*). This termination was effectuated on September 24, 2007. Mr. Emalfarb remained a director of the Company.

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

Note 3: Significant Events (Continued)

Management Changes (Continued)

The Company, in consultation with its outside legal counsel, based its action to terminate Mr. Emalfarb's employment on the conclusions of the third party investigation conducted under the supervision of the Audit Committee. The Special Committee also determined, based on the investigation results and consultation with outside legal counsel, that (i) there were no improprieties on the part of any other member of the Company's then current management, and (ii) the then current management had made appropriate inquiry regarding the Asian subsidiaries (*Note 12*).

Following the termination of Mr. Emalfarb, several legal actions were commenced by Mr. Emalfarb against the Company which, among other things, challenged the credibility and independence of the third party investigation as well as the basis for such termination under his then employment agreement and sought to force a change in management of the Company through a court-ordered annual meeting of stockholders (*Note 6*).

On September 27, 2007, Dr. Glenn E. Nedwin resigned from all of his positions with the Company including as a member of the Board, interim President, Chief Scientific Officer, Executive Vice President of the Company and President of the Company's BioPharma Business.

On June 20, 2008, following the election of three new directors to the Board at the Company's annual meeting of stockholders, the Board re-appointed Mr. Emalfarb as Chief Executive Officer of the Company, and Mr. Emalfarb was elected Chairman of the Board (*Note 6*).

On the same day, the following officers of the Company resigned from all of their respective positions with the Company:

- Wayne Moor, Chief Executive Officer, President and a member of the Board;
- Lisa M. De La Pointe, Executive Vice President and Chief Financial Officer;
- Alexander (Sasha) Bondar, Executive Vice President and Chief Business Officer;
- Kent Sproat, Executive Vice President, Manufacturing;
- Daniel Michalopoulos, Ph.D., Senior Vice President, Research and Development; and
- Charles W. (Bill) Kling, IV, Senior Vice President of Sales and Marketing.

Note 4: Significant Agreements

Abengoa Agreements

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

Under the Abengoa Securities Purchase Agreement, the Company issued 2,136,752 shares of the Company's common stock to Abengoa for an aggregate purchase price of \$10,000,000 (*Note 6*). This strategic investment in the Company was to fund the Company's R&D activities in the field of cellulosic

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

Note 4: Significant Agreements (Continued)

Abengoa Agreements (Continued)

ethanol production as provided in the Abengoa R&D Agreement. If Abengoa sells all or a portion of its shares of Dyadic common stock after a one-year required holding period, the then remaining deferred R&D obligation balance will be reduced by Abengoa's profit from the sale of those shares.

Under the Abengoa Agreements, the Company agreed to spend not less than \$10,000,000 over a three-year period to conduct R&D activities for Abengoa and other collaboration partners. Under the Abengoa R&D Agreement, the Company sought to apply the C1 Platform Technology to the development and production of cost-effective enzyme mixtures and related processing and manufacturing technologies for commercial application in Abengoa's bioethanol (cellulosic ethanol) production process. If Dyadic were to successfully develop one or more enzyme manufacturing systems for Abengoa, Dyadic would have been entitled to receive license fees, technology transfer fees and royalties on ethanol produced at Abengoa's facilities which utilize Dyadic's technology.

As the Company did not enter into a transaction involving the sale of its securities totaling at least \$20,000,000 in gross proceeds within six months following the date of closing of the Abengoa Securities Purchase Agreement, the Company, on May 14, 2007, granted Abengoa a warrant to purchase 427,351 shares of the Company's common stock at an exercise price of \$5.85 per share having a term of three years as required by the terms of the Abengoa Securities Purchase Agreement. At December 31, 2008, none of these warrants had been exercised.

As of December 31, 2008 and 2007, unused proceeds of approximately \$3,333,000 and \$6,665,000, respectively, are recorded as deferred R&D obligations in the accompanying consolidated balance sheets and are being recognized as revenue as the expenses associated with the R&D program described above are incurred. The costs incurred in connection with the Abengoa Securities Purchase Agreement were included in other assets and will be amortized in relation to the revenue recognized under the deferred R&D obligation.

On February 18, 2009, the Company and Abengoa mutually agreed to terminate the Abengoa R&D Agreement, entered into a non-exclusive license agreement (the "Abengoa License Agreement") and mutually agreed to the release of certain claims between the parties in the ABNT Litigation (as defined below) (collectively, the "Abengoa Events") (*Note 6*). Under the Abengoa License Agreement, the Company granted Abengoa the right to use certain patent rights and know-how owned by the Company relating to the C1 Platform Technology for the large-scale production of enzymes for use in manufacturing biofuels (including cellulosic ethanol and butanol), power and/or chemicals. The Abengoa License Agreement provides for facility fees and royalties to be paid to Dyadic upon the commercialization of biofuels and other products which utilize the Company's materials and technologies. The Abengoa Events did not become effective until May 12, 2009, at which time the Company completed the delivery of certain materials to Abengoa which was a condition precedent to releasing the Abengoa License Agreement and a settlement agreement between the parties from escrow which made the Abengoa Events effective.

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

Note 4: Significant Agreements (Continued)

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 valued at \$500,000, during the first 12 months of the Codexis License Agreement. The entire Codexis Upfront Payment is non-refundable provided that the Company meets certain performance criteria. The Company satisfied these criteria on April 15, 2009, and received the Codexis Upfront Payment in full.

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

Note 5: Note Payable to Stockholder

On May 29, 2003, Dyadic-Florida obtained a \$3.0 million revolving loan from the MAE Trust and a group of other stockholders of the Company as evidenced by a revolving note (as amended, the “Revolving Note”) from Dyadic-Florida for the benefit of the MAE Trust which was due on January 2, 2004. The Revolving Note was secured by certain assets of Dyadic-Florida pursuant to a Security Agreement dated May 7, 2000, as amended, and a Security Agreement dated as of May 29, 2003, as amended, between Dyadic-Florida and the MAE Trust (collectively, the “Security Agreement”). At December 31, 2007, the principal amount outstanding under the Revolving Note was approximately \$2.4 million bearing interest at a rate of 8% per annum.

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

Note 5: Note Payable to Stockholder (Continued)

In consideration for the Revolving Note, the MAE Trust and a group of other shareholders of Dyadic-Florida were also collectively granted warrants to purchase up to 1.5 million shares of Dyadic-Florida's common stock at the lesser of \$4.50 per share or the conversion price of Dyadic-Florida's Series A Preferred Stock, expiring ten years from the date of grant (the "Note Warrants"). In August 2004, the exercise price of the Note Warrants was reduced to \$3.33 and the maturity date of the Revolving Note was extended to January 1, 2007. As a result, approximately \$343,000, representing the incremental fair value of the modified warrant as compared to the fair value of the original warrant immediately before the modification, was being amortized to interest expense through the new maturity date. On April 30, 2006, the maturity date of the Revolving Note was extended to January 1, 2008 and on March 21, 2007, the maturity date was extended to January 1, 2009. The then remaining unamortized portion of approximately \$36,000 of the beneficial conversion feature was amortized through this new maturity date. Approximately \$26,000 and \$20,000 was amortized to interest expense during the years ended December 31, 2008 and 2007, respectively. Interest expense on the Revolving Note, excluding the amortization of the beneficial conversion feature, was approximately \$336,000 and \$194,000, respectively, for the years ended December 31, 2008 and 2007.

On October 3, 2007, the Company received a written notice of default from the MAE Trust based on numerous events reported in the Company's previously issued press releases and filings with the SEC which the MAE Trust alleged to be events of default under the Revolving Note and Security Agreement and caused the MAE Trust, among other alleged defaults, to deem itself "insecure" (*Note 6*). On January 2, 2008, the Company received a letter from the MAE Trust declaring the Revolving Note to be in default and demanding immediate payment of the Revolving Note's principal, all interest accrued from October 1, 2007 forward, and legal fees incurred by the MAE Trust.

On November 14, 2008, the Company entered into an Amended & Restated Note (the "Note") for the benefit of the MAE Trust in the principal amount of \$2,424,941 which amended and replaced the Revolving Note. Under the Note, the Company is obligated to pay interest to the MAE Trust from and after January 1, 2008 at a rate of 14% per annum and also make certain scheduled payments pursuant to the terms therein. Deferred and unpaid interest under the Revolving Note or under the Note bears interest at a rate of 14% per annum. The Note was due on or before January 1, 2009 and repayable by the Company as follows: (i) \$1.0 million on or before the first to occur of December 15, 2008, or the date which Dyadic-Florida receives or is scheduled to receive the first payment under the Codexis License Agreement (*Note 4*); and 50% or such lesser percentage as the MAE Trust is willing to accept of each additional payment received by Dyadic-Florida under the Codexis License Agreement. The Secured Parties agreed that the Note is subject to the limitations of the Non-Disturbance Agreement (*Note 4*). At December 31, 2008, the principal amount outstanding under the Note was approximately \$2.4 million with accrued interest payable to stockholder of approximately \$194,000.

In connection with the Note, on November 14, 2008, the Company also entered into a Loan and Security Agreement (the "Loan Agreement") with the Secured Parties which superseded the Security Agreement. Among other things, the Security Agreement secures the borrowings under the Note with all of the assets of the Company and also provides for the re-pricing of certain warrants to purchase the Company's common stock previously issued to the MAE Trust and other loan participants in connection with the Revolving Note (*Note 8*).

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

Note 5: Note Payable to Stockholder (Continued)

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

The Note matured on January 1, 2009 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: Commitments and Contingencies

Leases

Jupiter, Florida Headquarters

The Company’s corporate headquarters are located in Jupiter, Florida. In 2007, the Company occupied approximately 8,482 square feet for a monthly rental rate of approximately \$17,000. From January through June 2008, the Company occupied approximately 6,847 square feet with a monthly rental rate of approximately \$14,000. As of July 2008, the Company occupies approximately 4,872 square feet with a monthly rental rate of approximately \$6,000 (*Note 12*). The lease expires on December 31, 2010.

Jupiter, Florida Laboratory

The Company leases a laboratory facility in Jupiter, Florida which consisted of approximately 2,000 square foot in 2007 for a monthly rental rate of approximately \$2,000 and, as of July 2008, consisted of approximately 3,500 square feet with a monthly rental rate of approximately \$4,000. The lease expires on June 30, 2013.

Greensboro, North Carolina Laboratory

The Company leases a 3,150 square foot laboratory facility and a storage building in Greensboro, North Carolina for a monthly rental rate of approximately \$2,100 in 2007 and 2008. On November 19, 2008, the Company renewed this lease at the same monthly rent for an additional year terminating on December 31, 2009.

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

Note 6: Commitments and Contingencies (Continued)

Leases (Continued)

The Netherlands Office and Laboratory

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

Poland Office and Warehouse

Dyadic Poland leased approximately 560 square feet of office space in Warsaw, Poland for an average monthly rate of approximately \$1,000 in 2007 and 2008. As of December 2008, Dyadic Poland leases approximately 237 square feet of office space for a monthly rate of approximately \$300.

Dyadic Poland leased storage space for loading and unloading activity in Warsaw, Poland for a monthly rate of approximately \$20,000 in 2007 and approximately \$27,000 in 2008. As of January 2009, Dyadic Poland leases storage space for a monthly rate of approximately \$8,000, which decreased to approximately \$5,000 as of July 2009. The charge for storage space is based on the number of pallets stored.

Davis, California, Laboratory

On April 1, 2007, the Company subleased a 5,955 square foot laboratory and general office facility in Davis, California for a monthly rental rate of approximately \$9,000 that expired on May 31, 2008.

Future minimum lease commitments due for facilities and equipment leases under non-cancellable operating leases at December 31, 2008 are as follows:

2009	\$	321,451
2010		299,937
2011		184,209
2012		138,573
2013 and thereafter		<u>26,600</u>
	\$	<u>970,770</u>

Rent expense under all operating leases for the years ended December 31, 2008 and 2007 totaled approximately \$482,000 and \$440,000, respectively, of which approximately \$44,000 and \$42,000 is included in cost of goods sold and approximately \$439,000 and \$398,000 is included in general and administrative expenses, respectively, in the accompanying consolidated statements of operations.

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

Note 6: Commitments and Contingencies (Continued)

Manufacturing Commitment

In October 1999, the Company entered into a manufacturing agreement (as amended, the “Polfa Agreement”) with Polfa Tarchomin S.A. (“Polfa”) for the large-scale manufacture of industrial enzymes at Polfa’s facilities in Warsaw, Poland. Polfa has been the Company’s main contract manufacturer having produced most of the Company’s enzyme requirements over the last ten years. The Polfa Agreement required monthly payments based on capacity usage, ultrafiltration costs, disposal costs, raw material costs, and reimbursement of plant modification costs. The Polfa Agreement had a term of ten years with options to renew for three additional ten-year periods. The Polfa Agreement is being accounted for as a service agreement and the additional modification costs are being treated as an operating lease. Accordingly, annual payments are reflected as a component of cost of goods sold in the annual period in which each payment is due.

As of May 2001, the Company agreed to pay Polfa approximately 1.8 million Euros for plant modification costs (the “First Polfa Modification”), payable in monthly installments plus interest at the monthly LIBOR rate (5.02% and 1.08% at December 31, 2007 and December 31, 2008, respectively) over a period of seven years. The Company paid a total of approximately 255,000 Euros and 85,000 Euros in 2007 and 2008, respectively, plus interest of 9,000 Euros and 1,000 Euros for the years ended December 31, 2007 and December 31, 2008, respectively, and has satisfied its obligations under the First Polfa Modification as of April 2008.

As of October 2006, the Company agreed to pay Polfa approximately 735,000 Euros for further expansion costs, payable in monthly installments of 9,000 Euros plus interest at the monthly LIBOR rate, over a period of seven years (the “Second Polfa Modification”). In 2007, the Company paid Polfa a total of approximately 278,000 Euros for the Second Polfa Modification consisting of a prepayment of 173,000 Euros in January 2007 as well as the full year payment of approximately 105,000 Euros paid on a monthly basis, plus interest of 20,000 Euros at the monthly LIBOR rate for such period. In 2008, the Company paid Polfa approximately 79,000 Euros which represented nine monthly payments plus interest of 13,000 Euros at the monthly LIBOR rate through September 2008, at which time the Company ceased making these payments. On August 14, 2008, the Company suspended all production with Polfa and mutually agreed to terminate the Polfa Agreement as well as all related agreements and settle any remaining obligations between the companies.

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

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

Note 6: Commitments and Contingencies (Continued)

Third Party R&D Commitment

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

Since 1995, the Company has worked with a third party contract research organization (the "CRO") on various R&D programs pursuant to multiple development agreements. On July 30, 2004, Dyadic-Florida and the CRO entered into a development agreement (as amended, the "Development Agreement") for R&D services not to exceed \$1,250,000. The initial term of the Development Agreement was twenty-six months which was subsequently amended to terminate on April 30, 2007. Upon commencement of the Development Agreement, Dyadic-Florida prepaid \$250,000 from which future invoices for services rendered would be deducted. Dyadic-Florida also reserved 300,300 shares of the Company's common stock for issuance to the CRO as R&D services were provided to Dyadic-Florida, at which time such shares would be deemed to be outstanding (*Note 7*). The Company issued 185,000 of these shares to the CRO in 2006, 65,200 shares on February 23, 2007 and 50,100 shares on April 10, 2007. The price used to calculate the number of shares issued was set at \$3.33 per share as negotiated as part of the Development Agreement. The stated value of the services rendered was then divided by the share price of \$3.33 to determine the number of shares earned.

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

The Company has recognized non-cash R&D expense of approximately \$0 and \$644,000 for the years ended December 31, 2008 and 2007, respectively, based on the fair market value of the services received for shares of stock on the measurement dates.

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

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

Note 6: Commitments and Contingencies (Continued)

Third Party R&D Commitment (Continued)

For the years ended December 31, 2008 and December 31, 2007, the Company paid the CRO a total of approximately \$1,107,000 and \$991,000, respectively.

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

Litigation, Claims and Assessments

SEC Action

In April 2007, the SEC initiated an informal inquiry of the Company (the "SEC Action") based on the Company's voluntary disclosures of alleged improprieties at its Asian subsidiaries. Both the Company's primary and excess insurance carriers have denied coverage for the SEC Action based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies. The Company is pursuing insurance coverage and reimbursement for expenses incurred by the Company relating to the SEC Action but there can be no assurance that the Company will be successful. The Company submitted an Offer of Settlement to the SEC which was accepted on June 4, 2009. The Company's Offer of Settlement included the issuance of a cease-and-desist order (the "Order") by the SEC against the Company which directed the Company to cease and desist from committing or causing any violations of certain clauses of the 1934 Act. The Order did not impose any monetary or other penalty on the Company, its officers or directors and the Company did not admit or deny any of the findings contained in the Order.

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 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

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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Mark A. Emalfarb Arbitration (Continued)

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.

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 5*) 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.

The Note matured on January 1, 2009 and has not been amended. 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.

PIPE Transaction Liquidated Damages

On October 11, 2007, the Company received written notice from T. Rowe Price Associates, Inc. ("T. Rowe Price") demanding rescission of the purchase by T. Rowe Price of 1,200,000 shares of the Company's common stock and warrants to purchase 240,000 shares of the Company's common stock under and in connection with that certain Securities Purchase Agreement dated as of November 17, 2006 (the "PIPE Securities Purchase Agreement"), and, in connection with such rescission, the return of the \$5,616,000 approximate purchase price paid by T. Rowe Price in the closing under the PIPE Securities Purchase Agreement. Pursuant to the PIPE Securities Purchase Agreement, the Company sold 2,787,000 shares of the Company's common stock and warrants to purchase 557,400 shares of the Company's common stock for an aggregate purchase price of approximately \$13.0 million in a private placement transaction (the "PIPE Transaction") which closed on December 1, 2006. T. Rowe Price's notice sought rescission based on a claim that the Company's representations in the PIPE Securities Purchase Agreement regarding its financial statements were false and the Company's warranties in such agreement

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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

PIPE Transaction Liquidated Damages (Continued)

were breached. The Company suspended indefinitely the use of its previously filed registration statement on Form S-3 covering the resale of shares of its common stock by investors who participated in the PIPE Transaction. During this suspension period, the Company was obligated to pay liquidated damages equal to 1% of the shares of the Company's common stock held by each investor on the date of such suspension multiplied by the purchase price paid by each investor which equaled approximately \$110,000 per month beginning on May 23, 2007, up to a maximum of approximately \$1.1 million. The Company incurred an aggregate of approximately \$1,104,000 in liquidated damages to the PIPE Transaction investors consisting of payments of approximately \$877,400 in 2007 and \$219,000 in 2008. As of December 31, 2008, the Company had satisfied all of its obligations to pay liquidated damages under the PIPE Securities Purchase Agreement.

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

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

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 (*Note 4*) pursuant to which Abengoa purchased 2,136,752 shares of the Company's common stock from the Company for an aggregate purchase price of \$10 million, 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 (*Note 3*). 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

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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Constructive Termination Claims (Continued)

interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies.

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.

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.

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

Note 6: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Real Estate Purchase Contract

In May 2005, the Company purchased an undeveloped 1.13 acre parcel of land in the Abacoa planned community located in Jupiter, Florida (the "Land") pursuant to a Commercial Land Purchase and Sale Agreement dated July 31, 2004 (the "Land Acquisition Agreement"). The Company subsequently assigned the Land Acquisition Agreement and the Land to the Company's wholly owned subsidiary, DREH (*Note 1*). Under the Land Acquisition Agreement, the Company was obligated to commence development of the Land by no later than July 31, 2007. During this period, the Company was prohibited from re-transferring the Land to any other person other than (i) in connection with a sale of the Company, (ii) to an affiliate of the Company, or (iii) with the approval of the Board (a majority of its independent directors), to the Francisco Trust, the MAE Trust and/or any entity that is controlled, directly or indirectly, by Mark A. Emalfarb and/or his family members. The Company obtained final approval from the Town of Jupiter to construct an approximately 40,000 square foot commercial office biotech research and development building. In July 2007, DREH sold the Land for \$1,200,000. The Company recognized a gain of \$200,000 which is included in other income in the accompanying consolidated statements of operations.

Reimbursement of Legal Expenses

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

Note 7: Capital Structure

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

Third Party R&D Activities

Since 1995, the Company has worked with the CRO on various R&D programs under multiple development agreements (*Note 6*). The Company issued 87,125 shares of its common stock for R&D services provided under the development agreements, valued at approximately \$644,000 based on the fair market value of the Company's common stock on the measurement dates for the years ended December 31, 2008 and 2007.

The Company issued 53,050 shares of its common stock on various dates during 2007 for stock option exercises for total cash proceeds of approximately \$165,000 (*Note 8*).

The Company issued 57,508 shares of its common stock on various dates during 2007 for warrant exercises for total cash proceeds of approximately \$316,000 (*Note 8*).

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

Note 7: Capital Structure (Continued)

PIPE Transaction

On November 17, 2006, the Company entered into the PIPE Securities Purchase Agreement with certain institutional investors to purchase 2,787,000 shares of Dyadic's common stock in a private placement at a price of \$4.68 per share and warrants to purchase up to 557,400 shares of its common stock at an exercise price of \$6.33 per share for gross proceeds of approximately \$13,043,000. The Company completed this private placement on December 1, 2006. Cowen and Company, LLC acted as the exclusive placement agent for the private placement for which Dyadic issued to it warrants to purchase up to 83,610 shares of its common stock at \$5.24 per share and warrants to purchase up to 16,722 shares of its common stock at \$6.33 per share.

The warrants issued to the investors became exercisable on May 31, 2007, have a term of three years, contain price adjustment and economic anti-dilution features, anti-dilution protection from stock splits and similar events, limited cashless exercise procedures and are callable by the Company under certain circumstances. The warrants issued to the placement agent are substantially identical to the warrants issued to the investors, except that (i) the warrant for 83,610 shares has an exercise price of \$5.24 per share rather than \$6.33 per share and (ii) they have a five-year term rather than a three-year term and (iii) they provide for unqualified cashless exercise procedures rather than limited cashless exercise procedures.

Strategic Process

On October 23, 2007, the Company entered into an engagement agreement with Gordian Group, LLC ("Gordian Group") which was amended on July 14, 2008, to serve as the Company's investment banker and financial adviser to assist the Company in evaluating, exploring and, if deemed appropriate, pursuing and implementing certain strategic and financial options available to the Company, including a possible sale, merger, restructuring, recapitalization, reorganization or other strategic or financial transaction (the "Strategic Process"). The Company and Gordian Group commenced the Strategic Process to maximize the realizable value of the Company's business and assets for all of the Company's stockholders, by soliciting indications of interest from identified third parties concerning the possible acquisition of the Company's outstanding stock or assets. On September 30, 2008, the Company terminated its relationship with Gordian Group.

Note 8: Share-Based Compensation

Issuances of Common Stock

During the year ended December 31, 2007, the Company received an aggregate of approximately \$501,000 in proceeds from the exercises of the following instruments: (i) warrants to purchase an aggregate of 57,508 shares of its common stock at an exercise price of \$5.50 per share, and (ii) stock options to purchase an aggregate of 53,050 shares of its common stock, granted under the 2001 Equity Plan (as defined below), with exercise prices ranging from \$2.40 to \$4.60 per share.

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

Note 8: Share-Based Compensation (Continued)

Issuances of Common Stock (Continued)

During the year ended December 31, 2008, the Company received no proceeds from the exercises of stock options or warrants.

Warrants

At December 31, 2008 and 2007, 6,775,227 shares of common stock have been reserved for issuance under outstanding warrants. All of the warrants are fully vested and have expiration dates ranging from October 29, 2009 to May 29, 2013. Information concerning the Company's warrant activity is as follows:

	2008		2007	
	Warrants	Weighted-Average Exercise Price	Warrants	Weighted-Average Exercise Price
Outstanding at the beginning of the year	6,775,227	\$ 5.11	6,405,384	\$ 5.06
Retired	(1,818,934)	3.71	-	-
Exercised	-	-	(57,508)	5.50
Granted	1,818,934	0.15	427,351	5.85
Outstanding at the end of the year	6,775,227	\$.15	6,775,227	\$ 5.11

On May 14, 2007, the Company granted Abengoa a warrant to purchase 427,351 shares of the Company's common stock at an exercise price of \$5.85 per share having a term of three years, as required by the terms of the Abengoa Securities Purchase Agreement if the Company did not enter into a transaction involving the sale of its securities totaling at least \$20,000,000 in gross proceeds within six months following the date of closing of the Abengoa Securities Purchase Agreement.

Repricing of Specified Warrants

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

Description of Equity Plans

The Company maintains the Dyadic International, Inc. 2001 Equity Compensation Plan (as amended and restated, the "2001 Equity Plan") and the Dyadic International, Inc. 2006 Stock Option Plan (the "2006 Option Plan") (the 2001 Equity Plan and the 2006 Option Plan are hereinafter collectively referred to as the "Equity Compensation Plans"). All options granted under the Equity Compensation

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

Note 8: Share-Based Compensation (Continued)

Description of Equity Plans (Continued)

Plans are service-based and typically vest over a four year period. As of December 31, 2008, there were 432,938 service-based options that were exercisable.

2001 Equity Plan

The 2001 Equity Plan was adopted by the Company in May 2001 and amended and restated as of January 1, 2005. Under the 2001 Equity Plan, 4,478,475 shares of common stock are currently reserved for issuance. Eligible participants under the 2001 Equity Plan include all employees and Key Advisors (as defined in the 2001 Equity Plan) of the Company as well as its Board members. Awards under the 2001 Equity Plan may consist of grants of incentive stock options and nonqualified stock options to purchase the Company's common stock as well as issuances of common stock. Such shares, if issued, may be subject to restrictions, as disclosed in the 2001 Equity Plan. In addition to stock options and stock grants, the 2001 Equity Plan allows for the issuance of Performance Units (as defined in the 2001 Equity Plan) to an employee or Key Advisor. Each Performance Unit represents the right to receive an amount in cash or in the Company's common stock, as determined by a committee of the Company's Board, based on the value of the Performance Unit, if established performance goals are met. As of December 31, 2008, there were 289,750 stock options outstanding and 3,861,975 available for grant under the 2001 Equity Plan. The terms of the stock options outstanding under the 2001 Equity Plan range between five and ten years.

2006 Stock Option Plan

The 2006 Option Plan was adopted by the Company in April 2006. The purpose of the 2006 Option Plan is to retain and attract key management, employees, non-employee directors and consultants by providing those persons with a proprietary interest in the Company. The Compensation Committee of the Board administers the 2006 Option Plan and may grant incentive stock options or nonqualified stock options that do not comply with Section 422 of the Internal Revenue Code. Under the 2006 Option Plan, 2,700,000 shares of common stock have been reserved for issuance. As of December 31, 2008, there were 1,652,750 stock options outstanding and 1,045,000 available for grant under the 2006 Option Plan. The term of the options outstanding under the 2006 Option Plan is ten years.

Valuation of Stock Options

Share-based compensation related to stock options is determined using the single option approach under the Black-Scholes valuation model. The fair value of options determined under SFAS 123(R) is amortized to expense over the vesting periods of the underlying options, generally four or five years.

The fair value of stock option awards for the years ended December 31, 2008 and 2007 was estimated on the date of grant using the assumptions in the following table. The expected volatility in this model is based on the historical volatility of the Company's stock. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time awards are granted, based on maturities which approximate the expected life of the options. The expected life of the options granted is estimated using

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

Note 8: Share-Based Compensation (Continued)

Description of Equity Plans (Continued)

Valuation of Stock Options (Continued)

the historical exercise behavior of employees. The expected dividend rate takes into account the absence of any historical payments and the Board's intention to retain all earnings, if any, for future operations and expansion.

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

	<u>Year Ended</u> <u>December 31, 2008</u>	<u>Year Ended</u> <u>December 31, 2007</u>
Average Risk-Free Interest Rate	3.79%	4.68%
Dividend Yield	0.00%	0.00%
Average Volatility Factor	70.25%	70.48% - 73.08%
Average Option Life	10 years	10 years

Repricing of Specified Stock Options

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

Forfeiture Rate for Options

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

During the years ended December 31, 2008 and 2007, the Company terminated approximately 27 and 30 employees, respectively. As a result, 1,440,096 un-vested stock options outstanding to such employees were forfeited, resulting in a revision of the forfeiture rate of 100%. A cumulative adjustment of \$930,844 was recorded as a reduction to non-cash share-based compensation expense in the Company's results of operations for the year ended December 31, 2007.

The Company considered its historical experience of option forfeitures as the basis to arrive at its estimated average option forfeiture rate of 5% per year for remaining options for the years ended December 31, 2008 and 2007 for all stock option awards.

The Company recognized non-cash share-based compensation expense/recovery for its share-based awards of approximately \$326,000 and \$(109,000) for the years ended December 31, 2008 and 2007, respectively. These charges had no impact on the Company's reported cash flows.

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

Note 8: Share-Based Compensation (Continued)

Description of Equity Plans (Continued)

Total non-cash share-based compensation expense/(recovery) was allocated among the following expense categories:

	Year Ended December 31,	
	2008	2007
General and administrative	\$ 176,256	\$ 441,572
Research and development	32,615	(739,786)
Cost of goods sold	50,038	86,395
Sales and marketing	67,467	102,647
	\$ 326,376	\$ (109,172)

Equity Compensation Plans Awards Activity

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

	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2006	2,961,911	\$ 4.12
Granted	762,250	5.83
Exercised	(53,050)	3.11
Expired	-	-
Cancelled	(1,836,555)	4.69
Outstanding at December 31, 2007	1,834,556	4.29
Granted	2,008,500	0.15
Exercised	-	-
Expired	(46,000)	4.50
Cancelled	(1,853,556)	4.08
Outstanding at December 31, 2008	1,943,500	\$ 0.24
Exercisable at December 31, 2008	432,938	\$ 0.55

The weighted average grant date fair values of stock options granted during the years ended December 31, 2008 and 2007 were \$0.16 and \$3.67 per share, respectively.

Cash received from stock option exercises during the years ended December 31, 2008 and 2007 was \$0 and \$165,143, respectively. The Company has a net operating loss carryforward as of December 31, 2008 and, therefore, no excess tax benefits for tax deductions related to the stock options were recognized.

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

Note 8: Share-Based Compensation (Continued)

Description of Equity Plans (Continued)

Equity Compensation Plans Awards Activity (Continued)

A further detail of the options outstanding as of December 31, 2008 is set forth as follows:

Range of Exercise Prices	Options Outstanding	Weighted- Average Remaining Life in Years	Weighted- Average Exercise Price Per Share	Options Exercisable	Weighted- Average Exercise Price Per Share
\$0.15	1,918,500	8.98	\$0.15	407,938	\$0.15
\$7.13	25,000	1.27	\$7.13	25,000	\$7.13

Unrecognized Share-Based Compensation Expense

As of December 31, 2008, there was approximately \$141,000 of total unrecognized compensation expense related to non-vested share-based compensation arrangements granted under the Equity Incentive Plans. This expense is expected to be recognized over a weighted-average period of 2.9 years as follows:

Fiscal Year 2009	\$ 82,177
Fiscal Year 2010	36,697
Fiscal Year 2011	16,285
Fiscal Year 2012	<u>6,230</u>
	<u>\$ 141,389</u>

Note 9: Employee Benefit Plan

The Company offered a 401(k) defined contribution plan in which all employees were eligible to participate up until June 15, 2008, at which time the Company ceased offering this benefit to its employees (the "Former 401(k) Plan"). On October 1, 2009, the Company re-instituted a 401(k) defined contribution plan (the "New 401(k) Plan") on substantially the same terms and conditions as the Former 401(k) Plan. Under the New 401(k) Plan, participants may elect to defer up to 100% (as compared to 80% under the Former 401(k) Plan) of compensation up to a maximum amount determined annually pursuant to Internal Revenue Service regulations. Employee contributions may begin ninety days after the date of hire (as compared to on the date of hire under the Former 401(k) Plan) and are immediately vested. The New 401(k) Plan continues to provide a safe harbor basic match contribution for all eligible employees who make salary deferrals. The match contribution is equal to 100% of the employee's salary deferral up to 4% of such employee's annual deferred compensation (as compared to 3% of compensation, plus 50% of the salary deferral which exceeds 3% but does not exceed 5% of compensation under the Former 401(k) Plan). This match contribution was and is credited to the employee's account in both plans and is 100% vested. A total of approximately \$89,000 of match contribution expense was reported for the year ended December 31, 2007 and approximately \$34,000 for the year ended December 31, 2008 as set forth in the accompanying consolidated statements of operations.

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

Note 10: Segment Data Information and Concentrations of Business Risk

Segment Information

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

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

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

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

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

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

Segment Information (Continued)

	Year Ended December 31, 2007			
	U.S. Operating Segment	Netherlands Operating Segment	Eliminations	Total
Total Net Revenues	\$ 13,089,081	\$ 190,873	\$ -	\$ 13,279,954
Loss from Operations	(15,070,529)	(825,624)	-	(15,896,153)
Interest Income	1,090,610	2,168	-	1,092,778
Interest Expenses	(272,252)	-	-	(272,252)
Depreciation and amortization	(237,427)	(32,614)	-	(270,041)
Total assets at December 31, 2007	26,122,469	807,325	(839,108)	26,090,686

Concentrations

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

For the year ended December 31, 2008, there were two customers that accounted for 10% or greater of net sales, which represented in the aggregate approximately 30% of total net revenue related to product sales. For the year ended December 31, 2007, there were no customers that accounted for 10% or greater of net revenue related to product sales. As of December 31, 2008, there was one customer whose trade receivable balance was 42% of total accounts receivable. As of December 31, 2007, there were two customers whose trade receivable balance was approximately 18% and 10% of total accounts receivable, respectively.

The Company conducts operations in Poland and the Netherlands through its foreign subsidiaries. The net assets of the Company as of December 31, 2008 that have foreign currency exchange exposure and the related foreign currencies are as follows: approximately 420,000 Euros favorable difference and (242,000) Polish Zloty unfavorable difference, respectively.

The Company generates a large portion of its product sales to customers that are located outside the U.S. Sales to external customers attributed to foreign countries, defined as the location of the corporate office of those customers, totaled approximately \$7,505,000 and \$8,502,000 for the years ended December 31, 2008 and 2007, respectively (*Note 6*).

The Company does not own enzyme manufacturing facilities and relies on third party contract manufacturers to produce all of its enzymes. The Company's main contract manufacturer has been Polfa located in Warsaw, Poland, which has produced substantially all of the Company's commercial enzymes for the last ten years until the Polfa Agreement was terminated in August 2008 (*Note 6*). The Company has and will continue to utilize other third party manufacturers to fulfill its future production needs. In order to grow its business, the Company will require additional manufacturing capacity. There is no assurance that the Company will be able to maintain its current manufacturing capacity or be able to secure additional capacity on acceptable terms and conditions as and when needed by the Company. Any

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

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

Concentrations (Continued)

interruption in or failure to secure such manufacturing capacity could have a material adverse effect on the Company's results of operations.

Note 11: Income Taxes

No provision for U.S income taxes has been recognized for the year ended December 31, 2008 as the Company has incurred operating losses and has established a full valuation allowance. The Company's operations in Poland and the Netherlands are subject to income taxes in those jurisdictions.

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

	<u>2008</u>	<u>2007</u>
Current:		
U.S.	\$ -	\$ -
Foreign	-	-
	<u>\$ -</u>	<u>\$ -</u>
Deferred:		
U.S.	-	-
Foreign	-	-
	<u>\$ -</u>	<u>\$ -</u>

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

	<u>2008</u>	<u>2007</u>
United States	\$ 10,230,133	\$ 13,975,155
Other foreign	<u>2,136,265</u>	<u>1,528,865</u>
	<u>\$ 12,366,398</u>	<u>\$ 15,504,020</u>

The primary difference between the Company's income tax benefit computed at the U.S. statutory rate of 35% and the effective tax rates for the years ended December 31, 2008 and 2007 is the change in the valuation allowance in the respective periods that results from the Company fully offsetting the deferred income tax benefit of its net operating losses.

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

Note 11: Income Taxes (Continued)

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

	<u>2008</u>	<u>2007</u>
Current tax assets and liabilities:		
Allowance for Doubtful Accounts	\$ 104,000	\$ 7,000
Inventory reserves	471,000	558,000
Other items, net	(43,000)	290,000
Incentive stock options	91,000	90,000
Depreciation and amortization	138,000	236,000
	<u>761,000</u>	<u>1,181,000</u>
Non-current tax assets and liabilities:		
Net operating loss and tax credit carryforwards	24,709,000	19,579,000
Valuation allowance	<u>(25,470,000)</u>	<u>(20,760,000)</u>
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

SFAS 109 requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all the evidence, both positive and negative, management has determined that a full valuation allowance of approximately \$25,470,000 against its net deferred taxes is necessary as of December 31, 2008. The change in valuation allowance for the years ended December 31, 2008 and 2007 was approximately \$4,710,000 and \$5,860,000, respectively.

At December 31, 2008, the Company had approximately \$64,045,000 of U.S. net operating loss carryforwards remaining, which will expire beginning in 2021. As a result of certain ownership changes, the Company may be subject to an annual limitation on the utilization of its U.S. net operating loss carryforwards pursuant to Section 382 of the Internal Revenue Code. A study to determine the effects of this change, if any, has not been undertaken.

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

	<u>2008</u>	<u>2007</u>
Federal statutory taxes	35.00%	35.00%
State income taxes, net of federal tax benefit	3.58	3.58
Nondeductible items	(0.49)	(0.65)
Change in valuation allowance	<u>(38.09)</u>	<u>(37.93)</u>
	<u>- %</u>	<u>- %</u>

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

Note 12: Subsequent Events

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 as well as attorney Robert I. Schwimmer who previously represented the Company while at Jenkins & Gilchrist 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 who conducted the investigation and authored the investigative report requested by the Company’s Audit Committee following the discovery of alleged improprieties at the Company’s Asian subsidiaries. In addition to the claims contained in the original complaint, the Amended Complaint contains a claim of civil conspiracy against Ernst & Young 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* hereof.

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 Moscovitz & Moscovitz, Norman and Jane Moscovitz and Ernst & Young-Hong Kong have filed motions to dismiss with the Court which have been denied. Defendants Moscovitz & Moscovitz and Norman and Jane Moscovitz filed a motion to compel arbitration with the Court or alternatively to dismiss which has also been denied. 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.

Issuances of 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.

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

Note 12: Subsequent Events (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.

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.