



DYADIC INTERNATIONAL, INC.

Condensed Consolidated Financial Statements

June 30, 2009 and 2008

DYADIC INTERNATIONAL, INC.
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JUNE 30, 2009 AND 2008

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DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2009	December 31, 2008
ASSETS	(Unaudited)	
Current Assets:		
Cash and Cash Equivalents	\$ 9,891,000	\$ 2,826,542
Restricted Cash	343,158	344,355
Accounts Receivable, Net	1,513,447	1,504,200
Inventory, Net	3,140,674	3,775,750
Prepaid Expenses and Other Current Assets	<u>615,097</u>	<u>637,202</u>
Total Current Assets	15,503,376	9,088,049
Fixed Assets, Net		
Fixed Assets, Net	964,178	1,039,458
Intangible Assets, Net	155,353	162,420
Other Assets	<u>109,898</u>	<u>137,502</u>
	<u>\$ 16,732,805</u>	<u>\$ 10,427,429</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	\$ 2,359,173	\$ 2,678,794
Accrued Expenses	251,623	325,634
Accrued Interest Payable to Stockholder	27,106	194,260
Deferred Research and Development Obligation	250,000	3,332,863
Note Payable to Stockholder	1,424,941	2,424,941
Income Taxes Payable	<u>3,074</u>	<u>8,658</u>
Total Current Liabilities	<u>4,315,917</u>	<u>8,965,150</u>
Commitments and Contingencies		
Stockholders' Equity:		
Preferred Stock, \$.0001 Par Value:		
Authorized Shares – 5,000,000; None Issued and Outstanding	-	-
Common stock, \$.001 par value,		
Authorized Shares – 100,000,000; Issued and Outstanding – 30,040,675 and 29,990,675, Respectively	30,041	29,991
Additional Paid-In Capital	75,906,556	75,843,581
Accumulated Deficit	<u>(63,519,709)</u>	<u>(74,411,293)</u>
	<u>12,416,888</u>	<u>1,462,279</u>
	<u>\$ 16,732,805</u>	<u>\$ 10,427,429</u>

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

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

	<u>Six Months Ended June 30,</u>		<u>Three Months Ended June 30,</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue:				
Product Related Revenue, Net	\$ 3,210,964	\$ 4,725,355	\$ 1,754,765	\$ 2,195,001
Research and Development Revenue	<u>13,670,801</u>	<u>1,914,931</u>	<u>10,146,388</u>	<u>1,043,448</u>
Total Revenue, Net	16,881,765	6,640,286	11,901,153	3,238,449
Cost of Goods Sold:	<u>2,752,553</u>	<u>4,749,783</u>	<u>1,596,556</u>	<u>2,211,948</u>
Gross Profit	<u>14,129,212</u>	<u>1,890,503</u>	<u>10,304,597</u>	<u>1,026,501</u>
Expenses:				
General and Administrative	1,737,236	5,968,411	913,979	3,092,885
Sales and Marketing	549,546	1,495,717	278,529	730,031
Research and Development	861,723	2,662,096	478,521	1,406,090
Foreign Currency Exchange Losses (Gains), Net	<u>50,252</u>	<u>(63,662)</u>	<u>18,770</u>	<u>(1,453)</u>
Total Expenses	<u>3,198,757</u>	<u>10,062,562</u>	<u>1,689,799</u>	<u>5,227,553</u>
Income (Loss) from Operations	<u>10,930,455</u>	<u>(8,172,059)</u>	<u>8,614,798</u>	<u>(4,201,052)</u>
Other Income (Expense)				
Interest Income	70,995	127,491	48,116	28,765
Interest Expense	(109,866)	(200,202)	(43,316)	(135,174)
Other	<u>-</u>	<u>78,783</u>	<u>(1,198)</u>	<u>75,779</u>
Total Other Income (Expense), Net	<u>(38,871)</u>	<u>6,072</u>	<u>3,602</u>	<u>(30,630)</u>
Net Income (Loss)	<u>\$ 10,891,584</u>	<u>\$ (8,165,987)</u>	<u>\$ 8,618,400</u>	<u>\$ (4,231,682)</u>
Net Income (Loss) per Common Share				
Basic	<u>\$ 0.36</u>	<u>\$ (0.27)</u>	<u>\$ 0.29</u>	<u>\$ (0.14)</u>
Diluted	<u>\$ 0.33</u>	<u>\$ (0.27)</u>	<u>\$ 0.26</u>	<u>\$ (0.14)</u>
Weighted Average Common Shares Used in Calculating Net Income (Loss) Per Share:				
Basic	<u>30,027,962</u>	<u>29,990,675</u>	<u>30,002,830</u>	<u>29,990,675</u>
Diluted	<u>32,936,567</u>	<u>29,990,675</u>	<u>33,218,934</u>	<u>29,990,675</u>

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

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

	Six Months Ended June 30,	
	2009	2008
	(Unaudited)	(Unaudited)
Operating Activities		
Net Income (Loss)	\$ 10,891,584	\$ (8,165,987)
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided By (Used in) Operating Activities:		
Depreciation and Amortization of Fixed Assets	87,682	142,471
Amortization of Intangible and Other Assets	7,067	26,065
Amortization of Costs Related to Modification of Notes Payable to Stockholder	-	10,100
Provision for Doubtful Accounts	-	11,000
Reduction of Inventory Reserve	(490,414)	-
Compensation Expense on Stock Option Grants	58,025	161,846
Stock Issued for Rent	5,000	-
Changes in Operating Assets and Liabilities:		
Accounts Receivable	(9,247)	(125,126)
Inventory	1,125,490	(649,993)
Prepaid Expenses and Other Current Assets	22,105	(1,037,736)
Other Assets	27,604	22,568
Accounts Payable	(319,621)	(264,612)
Accrued Expenses	(74,011)	(655,535)
Accrued Interest Payable to Stockholder	(167,154)	71,687
Deferred Research and Development Obligation	(3,082,863)	(1,666,250)
Income Taxes Payable	(5,584)	2,711
Net Cash Provided By (Used In) Operating Activities	<u>8,075,663</u>	<u>(12,116,791)</u>
Investing Activities		
Purchases of Fixed Assets	(12,402)	(71,591)
Restricted Cash (Withdrawal) Deposit	1,197	(243,599)
Net Cash Provided By (Used In) Investing Activities	<u>(11,205)</u>	<u>(315,190)</u>
Financing Activities		
Repayment of Note Payable to Stockholder	(1,000,000)	-
Net Cash (Used In) Financing Activities	<u>(1,000,000)</u>	<u>-</u>
Net Increase (Decrease) in Cash and Cash Equivalents	7,064,458	(12,431,981)
Cash and Cash Equivalents at Beginning of Period	<u>2,826,542</u>	<u>15,953,984</u>
Cash and Cash Equivalents at End of Period	<u>\$ 9,891,000</u>	<u>\$ 3,522,003</u>
Supplemental Cash Flow Information:		
Cash Paid for Interest	<u>\$ 277,020</u>	<u>\$ 128,515</u>

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

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

Note 1: Basis of Presentation

General

The accompanying unaudited interim condensed consolidated financial statements for Dyadic International, Inc. and its subsidiaries (collectively, “Dyadic” or the “Company”) have been prepared in accordance with generally accepted accounting principles for interim financial reporting. Accordingly, certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted. In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments and the elimination of intercompany accounts) considered necessary for a fair statement of all periods presented. The results of Dyadic’s operations for any interim periods are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes for the year ended December 31, 2008.

Note 2: Inventory

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

Inventory consisted of the following:

	June 30, 2009	December 31, 2008
	(Unaudited)	
Finished goods	\$ 3,731,649	\$ 4,516,737
Raw materials	309,025	645,395
	4,040,674	5,162,132
Less reserve for obsolescence	(900,000)	(1,386,382)
	\$ 3,140,674	\$ 3,775,750

Note 3: Significant Agreements

Abengoa Agreements

On February 18, 2009, the Company and Abengoa Bioengery R&D, Inc. (“Abengoa”) mutually agreed to terminate the Abengoa R&D Agreement, entered into a non-exclusive license agreement (the “Abengoa License Agreement”) and mutually agreed to the release of certain claims between the parties in the ABNT Litigation (as defined below) (collectively, the “Abengoa Events”) (*Note 5*). 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

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

Note 3: Significant Agreements (Continued)

Abengoa Agreements (Continued)

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. The Company recognized the remaining research and development revenue related to the Abengoa License Agreement of approximately \$0 and \$833,000 for the three months ended June 30, 2009 and 2008, respectively, and approximately \$3,333,000 and \$1,666,000 for the six months ended June 30, 2009 and 2008, respectively. The Company has deferred research and development obligations of approximately \$0 and \$3,333,000 at June 30, 2009 and December 31, 2008, respectively (*Note 5*).

Codexis License Agreement

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

The Codexis License Agreement provides for the payment by Codexis to the Company of \$10 million (the "Codexis Upfront Payment") provided that certain performance criteria are satisfied by the Company. The Company is also obligated to provide Codexis with information and technical assistance including, but not limited to, access to two full-time equivalent scientists ("FTE") valued at \$500,000, during the first 12 months of the Codexis License Agreement. The entire Codexis Upfront Payment is non-refundable provided that the Company meets certain performance criteria. The Company satisfied these criteria on April 15, 2009, and received the Codexis Upfront Payment in full. The Company received \$5 million and \$10 million from Codexis during the three and six months ended June 30, 2009, respectively. The value of the FTE services that the Company is obligated to provide will be recognized on a straight-line basis over the 12 month service period, retroactively based on the initial delivery of material by Dyadic as stipulated by the terms of the Codexis License Agreement. The remaining portion of the Codexis Upfront Payment was recognized as research and development revenue upon the satisfaction of the performance criteria on April 15, 2009. The Company has recognized research and development revenue related to the Codexis License Agreement of \$9,750,000 during the three and six months ended June 30, 2009. At June 30, 2009, the Company had \$250,000 in deferred research and development obligations.

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

Note 4: Note Payable to Stockholder

The Amended and Restated Note dated as of November 14, 2008 (the “Note”) payable to the Mark A. Emalfarb Trust under agreement dated October 1, 1987, as amended (the “MAE Trust”), matured on January 1, 2009 and has not been amended since that time. On January 12, 2009, 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 5*).

Note 5: Commitments and Contingencies

Third Party R&D Commitment

On April 24, 2009, the Company and a third party contract research organization (the “CRO”) amended the 2008 Development Agreement to extend its term until April 30, 2010 for continued use of the CRO’s services on an hourly basis as required by the Company. The Company made a payment of \$10,000 to the CRO against which future technology transfer services may be deducted.

Litigation, Claims and Assessments

SEC Action

In April 2007, the SEC initiated an informal inquiry of the Company (the “SEC Action”) based on the Company’s voluntary disclosures of alleged improprieties at its Asian subsidiaries. Both the Company’s primary and excess insurance carriers have denied coverage for the SEC Action based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company’s insurance policies. The Company is pursuing insurance coverage for the SEC Action but there can be no assurance that the Company will be successful. The Company submitted an Offer of Settlement to the SEC which was accepted on June 4, 2009. The Company’s Offer of Settlement included the issuance of a cease-and-desist order (the “Order”) by the SEC against the Company which directed the Company to cease and desist from committing or causing any violations of certain clauses of the 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 of Directors and/or outside advisors. This action was settled with a settlement stipulation being approved by the Court on February 18, 2008. On May 19, 2009, this action was dismissed with prejudice.

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

Note 5: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Mark A. Emalfarb Arbitration

On September 25, 2007, Mark A. Emalfarb commenced an arbitration proceeding (the “Emalfarb Arbitration”) against the Company before the American Arbitration Association seeking monetary damages resulting from the termination for cause of his employment agreement dated as of April 1, 2001 (as amended, the “Employment Agreement”), asserting, among other things, that “cause” as defined in the Employment Agreement, did not exist and that his reputation had been damaged by the Company. On October 22, 2007, the Company filed an answering statement and motion to dismiss the arbitration. On April 1, 2008, Mr. Emalfarb responded to Dyadic’s answering statement and motion to dismiss and filed a Supplemental Demand for Arbitration against Dyadic asserting various counts and demanding full recompense from the Company for damages relating to such termination. Both the Company’s primary and excess insurance carriers have denied coverage for the Emalfarb Arbitration based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company’s insurance policies. The Company is pursuing insurance coverage for the Emalfarb Arbitration but there can be no assurance that the Company will be successful. This arbitration is currently stayed indefinitely but may be re-initiated by Mr. Emalfarb at any time.

Mark A. Emalfarb Trust Revolving Note

On October 3, 2007, the Company received a written notice of default from the MAE Trust pursuant to the Revolving Note and the Security Agreement (*Note 4*) based on numerous events reported in the Company’s previously issued press releases and filings with the SEC which the MAE Trust alleged to be events of default under the Revolving Note and Security Agreement and caused the MAE Trust to deem itself “insecure.” On January 2, 2008, the Company received a letter from the MAE Trust declaring the Revolving Note to be in default and demanding immediate payment of the Revolving Note’s principal, all interest accrued from October 1, 2007 forward, and legal fees incurred by the MAE Trust.

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.

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.

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

Note 5: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Class Action Stockholder Lawsuit (Continued)

Warner (collectively, the “Defendants”). Capital Max alleges violations of Section 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78j(b) and 78t(a) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, based on the alleged failure of the Defendants to disclose in statements to the SEC and to the investing public actual occurrences of, and risk of, financial and operational improprieties by the Company’s Asian subsidiaries during the Class Period. In its Order of November 25, 2008, the Court dismissed the Amended Consolidated Class Action Complaint as to Defendants Richard J. Berman, Harry Z. Rosengart, Stephen J. Warner and Wayne Moor without prejudice. The Court denied the motions to dismiss filed by Defendant Mark A. Emalfarb and the Company.

On December 22, 2008, Capital Max filed the Second Amended and Consolidated Class Action Complaint (the “Second Amended Complaint”). In January 2009, Defendants Gardner, Berman, Rosengart, Warner and Moor filed motions to dismiss the Second Amended Complaint. On September 29, 2009, the Court dismissed the Section 10(b) count of the Second Amended Complaint with prejudice with respect to Messrs. Berman, Rosengart and Warner leaving Messrs. Emalfarb, Gardner and Moor as well as the Company to defend against such claim. The Court denied the motions to dismiss by Messrs. Berman, Rosengart, Warner, Gardner and Moor with respect to the Section 20(a) count leaving those Defendants along with Mr. Emalfarb and the Company to defend against such claim. Both the Company’s primary and excess insurance carriers have denied coverage for the Class Action Litigation based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company’s insurance policies. The Company intends to vigorously defend against this Class Action Litigation and is pursuing insurance coverage from its insurance carriers but there can be no assurance that the Company will be successful.

Abengoa Litigation

On November 7, 2007, Abengoa filed a complaint in the Circuit Court of the 15th Judicial Circuit in and for Palm Beach County, Florida against the Company and Mark A. Emalfarb, a director of the Company (the “ABNT Litigation”). The ABNT Litigation relates to the Abengoa Securities Purchase Agreement pursuant to which Abengoa purchased 2,136,752 shares of the Company’s common stock from the Company for an aggregate purchase price of \$10 million, which closed on November 8, 2006. The lawsuit claimed that one or both defendants, among other things, defrauded Abengoa, violated Delaware securities laws, breached the covenant of good faith and fair dealing, and breached the Abengoa Securities Purchase Agreement by making various false and misleading representations that Abengoa relied upon in entering into and closing its purchase of Company shares. Abengoa alleged that the stock it purchased was rendered virtually valueless and unmarketable following the Company’s announcements relating to alleged improprieties at its Asian subsidiaries, the extent of the Company’s former President and Chief Executive Officer’s knowledge of those alleged improprieties and that the annual and quarterly reports filed with the SEC could no longer be relied upon. The complaint sought indemnification under the Abengoa Securities Purchase Agreement, monetary damages of at least \$10 million, and the costs and expenses incurred in prosecuting the action, among other things. Both the Company’s primary and excess insurance carriers have denied coverage for the ABNT Litigation based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company’s insurance policies.

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

Note 5: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Abengoa Litigation (Continued)

The Company is pursuing insurance coverage of the ABNT Litigation from its insurance carriers but there can be no assurance that the Company will be successful. The ABNT Litigation was settled and voluntarily dismissed with prejudice on May 13, 2009.

Mark A. Emalfarb Annual Meeting Demand

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

Constructive Termination Claims

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

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.

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

Note 5: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Excess Insurance Carrier Litigation

On November 3, 2008, the Company's excess insurance carrier filed a declaratory action in the Circuit Court of the 15th Judicial Circuit in and for Palm Beach County, Florida against the Defendants and Capital Max (collectively, the "Insurance Defendants") seeking a declaration that the carrier has no obligation to provide coverage for the Class Action Litigation. The coverage at issue is an excess policy to the Company that covered the time period from October 27, 2006 to October 27, 2007. The excess carrier has denied coverage for the Class Action Litigation based on its interpretation of exclusions contained in the Company's insurance policy. On July 29, 2009, the Court granted the Insurance Defendants' motion to stay the action which is currently stayed indefinitely.

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.

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 (*Note 10*).

On April 14, 2009, the Company amended the complaint (the "Amended Complaint") by naming as additional defendants the Company's former outside legal counsel consisting of the law firms of Greenberg Traurig, LLP, Greenberg Traurig, P.A. (collectively, "Greenberg Traurig"), Jenkens & Gilchrist, P.C. and Bilzin Sumberg Baena Price & Axelrod LLP as well as attorney Robert I. Schwimmer who previously represented the Company while at Jenkens & Gilchrist and later at Greenberg Traurig. The Company also named as defendants the law firm of Moscowitz & Moscowitz, P.A. and its attorneys, Norman A. Moscowitz and Jane W. Moscowitz 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 of the consolidated financial statements of Dyadic for the year ended December 31, 2008.

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

Note 6: Common Stock

Landlord Issuance

On May 18, 2009, the Company issued 50,000 shares of the Company's common stock to the landlord of the Company's headquarters in Jupiter, Florida in exchange for certain rent and occupancy concessions under an agreement entered into on November 6, 2008 with a value of \$5,000 based on the then current stock price.

Note 7: Share-Based Compensation

On February 26, 2009, the Company granted to its employees 629,000 stock options to purchase shares of the Company's common stock at an exercise price of \$0.23 per share. The stock options vest over four years and expire on February 26, 2019. The fair market value of such stock options was \$0.20 per stock option based on the Black-Scholes valuation model. Assumptions used in the Black-Scholes valuation model for options granted were as follows:

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

There were no stock option exercises, cancellations or expirations during the three and six months ended June 30, 2009.

The Company recognized non-cash share-based compensation expense for its share-based awards of approximately \$28,000 and \$80,000 for the three months ended June 30, 2009 and 2008, respectively, and approximately \$58,000 and \$162,000 for the six months ended June 30, 2009 and 2008, respectively. These charges had no impact on the Company's reported cash flows. Total non-cash share-based compensation expense was allocated among the following expense categories:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
General and administrative	\$ 20,065	\$ 43,935	\$ 42,100	\$ 87,404
Research and development	2,185	8,131	4,584	16,173
Cost of goods sold	2,359	12,475	4,949	24,813
Sales and marketing	3,009	15,118	6,392	33,456
	<u>\$ 27,618</u>	<u>\$ 79,659</u>	<u>\$ 58,025</u>	<u>\$ 161,846</u>

Note 8: Income Taxes

At June 30, 2009, the Company had significant net operating loss carryforwards remaining which expire beginning in 2021. The Company has determined that a full valuation allowance against its net deferred taxes is necessary as of June 30, 2009.

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

Note 9: Segment Data Information

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

	Six Months Ended June 30, 2009			
	U.S. Operating Segment	Netherlands Operating Segment	Eliminations	Total
Net Revenue	\$ 16,593,827	\$ 287,938	\$ -	\$ 16,881,765
Income from Operations	11,527,109	(596,654)	-	10,930,455
Interest Income	65,818	5,177	-	70,995
Interest Expense	(109,866)	-	-	(109,866)
Capital Expenditures	(12,402)	-	-	(12,402)
Depreciation and Amortization	(94,749)	-	-	(94,749)
Total Assets	16,682,044	1,044,337	(993,576)	16,732,805

	Six Months Ended June 30, 2008			
	U.S. Operating Segment	Netherlands Operating Segment	Eliminations	Total
Net Revenue	\$ 6,391,605	\$ 248,681	\$ -	\$ 6,640,286
Loss from Operations	(7,452,733)	(719,326)	-	(8,172,059)
Interest Income	116,702	10,789	-	127,491
Interest Expense	(200,202)	-	-	(200,202)
Capital Expenditures	(71,591)	-	-	(71,591)
Depreciation and Amortization	(146,265)	(22,271)	-	(168,536)
Total Assets	15,349,377	1,261,764	(1,026,494)	15,584,647

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

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

Note 9: Segment Data Information (Continued)

	Three Months Ended June 30, 2008		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 3,028,126	\$ 210,323	\$ 3,238,449
Loss from Operations	(3,891,599)	(309,453)	(4,201,052)
Interest Income	17,976	10,789	28,765
Interest Expense	(135,174)	-	(135,174)
Capital Expenditures	(71,591)	-	(71,591)
Depreciation and Amortization	(84,966)	-	(84,966)

Note 10: Subsequent Events

The Company has evaluated these unaudited interim condensed consolidated financial statements for subsequent events through October 26, 2009.

Litigation

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 Moscowitz & Moscowitz, Norman and Jane Moscowitz and Ernst & Young-Hong Kong have filed motions to dismiss with the Court which have been denied. Defendants Moscowitz & Moscowitz and Norman and Jane Moscowitz 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

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.