



**DYADIC INTERNATIONAL, INC.
AND SUBSIDIARIES**

Condensed Consolidated Financial Statements

September 30, 2011

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

	September 30, 2011	December 31, 2010
ASSETS	<u>(Unaudited)</u>	
Current Assets:		
Cash and Cash Equivalents	\$ 4,039,753	\$ 4,535,279
Restricted Cash	256,628	247,082
Accounts Receivable, Net	1,344,250	1,276,574
Inventory, Net	2,702,264	2,782,433
Prepaid Expenses and Other Current Assets	<u>347,631</u>	<u>336,638</u>
Total Current Assets	8,690,526	9,178,006
Fixed Assets, Net	606,445	719,161
Intangible Assets, Net	413,634	310,978
Other Assets	<u>16,930</u>	<u>16,930</u>
	<u>\$ 9,727,535</u>	<u>\$ 10,225,075</u>
 LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Accounts Payable	\$ 1,199,079	\$ 1,801,123
Accrued Expenses	436,949	417,996
Accrued Interest Payable	114,778	146,230
Deferred Research and Development Obligation	155,648	-
Note Payable to Stockholder	1,424,941	1,424,941
Income Taxes Payable	<u>168</u>	<u>168</u>
Total Current Liabilities	3,331,563	3,790,458
Convertible Subordinated Debt	<u>6,400,000</u>	<u>4,000,000</u>
	<u>9,731,563</u>	<u>7,790,458</u>
 COMMITMENTS AND CONTINGENCIES		
Stockholders' Equity (Deficit):		
Preferred Stock, \$.0001 Par Value:		
Authorized Shares – 5,000,000; None Issued and Outstanding	-	-
Common Stock, \$.001 par value,		
Authorized Shares – 100,000,000; Issued and		
Outstanding – 31,427,495 and 31,138,120, Respectively	31,428	31,138
Additional Paid-in Capital	78,219,580	77,101,690
Accumulated Deficit	<u>(78,255,036)</u>	<u>(74,698,211)</u>
	<u>(4,028)</u>	<u>2,434,617</u>
	<u>\$ 9,727,535</u>	<u>\$ 10,225,075</u>

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

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

	Nine Months Ended		Three Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue:				
Product Related Revenue, Net	\$ 5,492,082	\$ 5,541,489	\$ 2,039,528	\$ 1,922,552
License Fee Revenue	1,017,000	32,000	-	-
Research and Development Revenue	1,349,985	617,695	535,883	64,120
Total Revenue	<u>7,859,067</u>	<u>6,191,184</u>	<u>2,575,411</u>	<u>1,986,672</u>
Cost of Goods Sold	<u>5,004,147</u>	<u>4,738,392</u>	<u>1,790,994</u>	<u>1,647,413</u>
Gross Profit	<u>2,854,920</u>	<u>1,452,792</u>	<u>784,417</u>	<u>339,259</u>
Expenses:				
General and Administrative	4,353,282	3,740,039	1,340,945	1,105,897
Sales and Marketing	807,199	738,757	270,746	266,161
Research and Development	910,597	920,444	288,480	271,809
Foreign Currency Exchange Losses (Gains), Net	6,183	137,852	87,527	(122,691)
Total Expenses	<u>6,077,261</u>	<u>5,537,092</u>	<u>1,987,698</u>	<u>1,521,176</u>
(Loss) from Operations	<u>(3,222,341)</u>	<u>(4,084,300)</u>	<u>(1,203,281)</u>	<u>(1,181,917)</u>
Other Income (Expense):				
Interest Income	8,388	46,003	1,714	9,992
Interest Expense	(342,872)	(132,657)	(116,135)	(67,591)
Gain on Reduction of Accrued Stockholder Litigation	-	410,000	-	-
Other	-	(155,260)	-	(155,503)
Total Other Income (Expense)	<u>(334,484)</u>	<u>168,086</u>	<u>(114,421)</u>	<u>(213,102)</u>
Net (Loss)	<u>\$ (3,556,825)</u>	<u>\$ (3,916,214)</u>	<u>\$ (1,317,702)</u>	<u>\$ (1,395,019)</u>
Net (Loss) per Common Share				
Basic	<u>\$ (0.11)</u>	<u>\$ (0.13)</u>	<u>\$ (0.04)</u>	<u>\$ (0.04)</u>
Diluted	<u>\$ (0.11)</u>	<u>\$ (0.13)</u>	<u>\$ (0.04)</u>	<u>\$ (0.04)</u>
Weighted Average Common Shares Used in Calculating Net (Loss) Per Share:				
Basic	<u>31,317,553</u>	<u>30,971,296</u>	<u>31,413,614</u>	<u>31,063,147</u>
Diluted	<u>31,317,553</u>	<u>30,971,296</u>	<u>31,413,614</u>	<u>31,063,147</u>

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

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

	Nine Months Ended September 30,	
	2011	2010
	(Unaudited)	(Unaudited)
Operating Activities		
Net (Loss)	\$ (3,556,825)	\$ (3,916,214)
Adjustments to Reconcile Net (Loss) to Net Cash (Used In) Operating Activities:		
Depreciation and Amortization of Fixed Assets	193,128	230,999
Amortization of Intangible and Other Assets	23,675	11,465
Reduction of Allowance for Doubtful Accounts	(50,011)	(111,399)
Reduction of Inventory Reserve	(75,389)	(363,795)
Compensation Expense on Stock Option Grants	1,068,374	668,154
Stock Issued for Financial Services	-	63,000
Gain on Reduction of Accrued Stockholder Litigation	-	(410,000)
Changes in Operating Assets and Liabilities:		
Accounts Receivable	(17,665)	344,493
Inventory	155,558	248,567
Prepaid Expenses and Other Current Assets	(10,942)	129,288
Accounts Payable	(602,044)	(197,463)
Accrued Expenses	18,902	(222,143)
Accrued Interest Payable	(31,452)	6,253
Accrued Stockholder Litigation	-	(2,840,000)
Deferred Research and Development Obligation	155,648	-
Income Taxes Payable	-	1,238
Net Cash (Used In) Operating Activities	<u>(2,729,043)</u>	<u>(6,357,557)</u>
Investing Activities		
Purchases of Fixed Assets	(80,412)	(166,446)
Cost of Patents	(126,331)	(81,228)
Restricted Cash	(9,546)	12,036
Net Cash (Used In) Investing Activities	<u>(216,289)</u>	<u>(235,638)</u>
Financing Activities		
Proceeds from Issuance of Convertible Subordinated Debt	2,400,000	4,000,000
Proceeds from Stock Warrant Exercises	15,000	16,876
Proceeds from Stock Option Exercises	34,806	31,197
Net Cash Provided by Financing Activities	<u>2,449,806</u>	<u>4,048,073</u>
Net (Decrease) in Cash and Cash Equivalents	(495,526)	(2,545,122)
Cash and Cash Equivalents at Beginning of Period	4,535,279	8,419,934
Cash and Cash Equivalents at End of Period	<u>\$ 4,039,753</u>	<u>\$ 5,874,812</u>
Supplemental Cash Flow Information		
Cash Paid for Interest	<u>\$ 374,324</u>	<u>\$ 126,404</u>

The Accompanying Notes are an Integral Part of these 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 Subsidiaries (collectively, “Dyadic” or the “Company”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial reporting. Accordingly, certain information and footnote disclosures normally included in annual consolidated financial statements have been condensed or omitted. In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements reflect all material and known adjustments (consisting of only normal recurring adjustments and the elimination of intra-entity accounts) considered necessary for a fair statement of all periods presented. The results of Dyadic’s operations for any interim periods are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes for the year ended December 31, 2010.

Net Loss Per Common Share

Basic loss per share excludes any dilution. It is based upon the weighted average number of common shares outstanding during the period. Diluted loss per share excludes the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. As of September 30, 2011, 2,610,068 shares of common stock underlying stock options and warrants were not included in computing diluted earnings per share because their effects were anti-dilutive.

Research and Development Revenue Recognition

The Company applies a proportional-performance model using the percentage-of-completion method of revenue recognition associated with activities performed under certain research and development agreements. Since the expected cost to perform the activities can be reasonably estimated, the Company believes a proportional-performance methodology of revenue recognition is appropriate. Under this method, revenue in any period is recognized as a percentage of the total actual cost expended relative to the total estimated costs required to satisfy the performance obligations under the research and development arrangements. Revenue recognized is limited to the amounts that are non-refundable and that the other party to the agreement is contractually obligated to pay to the Company. A change in the period of time expected to complete the activities is accounted for as a change in estimate on a prospective basis.

Deferred Research and Development Obligation

The deferred research and development obligation represents payments received or receivable for certain research and development activities which are deferred until revenue can be recognized under the Company’s revenue recognition policy. Deferred revenue is classified as current if management believes the Company will be able to recognize the deferred amount as revenue within 12 months of the balance sheet date. At September 30, 2011, the total deferred research and development obligation was approximately \$156,000.

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of Presentation (Continued)

Multiple Deliverable Arrangements Revenue Recognition

The Company evaluates multiple deliverable arrangements contained in its collaboration and license agreements in accordance with the guidance of multiple deliverable arrangements to determine whether the delivered elements that are the obligation of the Company have value to other parties to the agreement on a stand-alone basis and whether objective reliable evidence of fair value of the undelivered items exists. Deliverables that meet these criteria are considered a separate unit of accounting. Deliverables that do not meet these criteria are combined and accounted for as a single unit of accounting. The appropriate recognition of revenue is then applied to each separate unit of accounting.

Note 2: Inventory

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

Inventory consisted of the following:

	September 30, 2011 (Unaudited)	December 31, 2010
Finished goods	\$ 2,743,692	\$ 2,860,435
Raw materials	8,572	47,387
	2,752,264	2,907,822
Less: reserve for obsolescence	(50,000)	(125,389)
	\$ 2,702,264	\$ 2,782,433

Note 3: Notes Payable and Subsequent Event

Note Payable to Stockholder

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

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 3: Notes Payable and Subsequent Event (Continued)

Interest expense on the Note Payable to Stockholder amounted to approximately \$34,000 for both the three months ended September 30, 2011 and 2010, respectively. Interest expense for both the nine months ended September 30, 2011 and 2010 was \$101,000, respectively.

Convertible Subordinated Debt

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

Approximately \$1,300,000 of the Notes are held by four related party interests which includes members of management and the Board of Directors, as well as another related party. Interest expense on the convertible subordinated debt was approximately \$81,000 and \$242,000 for the three and nine months ended September 30, 2011, respectively.

On September 30, 2011, the Company completed the private placement of \$3,000,000 aggregate principal of convertible subordinated secured promissory notes (the "2011 Notes") with certain investors, of which \$2,400,000 was received on September 30, 2011. Proceeds from the remaining \$600,000 2011 Notes were received in October 2011 from three related party interests which include a member of management, a member of the Board of Directors and another related party. The 2011 Notes pay interest quarterly at 8% per annum and include a convertibility feature at the holder's option. The 2011 Notes are convertible into restricted shares of the Company's common stock at a price equal to the lesser of \$1.82 per share, or 120% of the average closing price of the Company's common stock for the 30-day period immediately following the date on which the Company publicly announces the final determination of its binding arbitration discussed in Note 4. The Company will not effect any conversion of the 2011 Notes, to the extent that after giving effect to such conversion, any holder would beneficially own in excess of 4.9% of the Company's outstanding common stock. The Beneficial Ownership Limitation may be waived by the holder upon not less than 61 days prior notice. The 2011 Notes are subordinated to the Note Payable to Stockholder and the Notes, are collateralized by the assets of the Company and mature on January 1, 2013.

Note 4: Commitments and Contingencies

Manufacturing Commitment

The Company manufactures its enzymes with a 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 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 4: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments

Pending Actions

Professional Liability Lawsuit

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

On April 14, 2009, the Company amended the complaint (the "Amended Complaint") by naming as additional defendants the Company's former outside legal counsel consisting of the law firms of Greenberg Traurig, LLP, Greenberg Traurig, P.A. (collectively, "Greenberg Traurig"), Jenkens & Gilchrist, P.C. ("Jenkins & Gilchrist") and Bilzin Sumberg Baena Price & Axelrod LLP ("Bilzin Sumberg") as well as attorney Robert I. Schwimmer who previously represented the Company while an attorney at Jenkins & Gilchrist and later at Greenberg Traurig. The Company also named as defendants the law firm of Moscovitz & Moscovitz, P.A. and its attorneys, Norman A. Moscovitz and Jane W. Moscovitz (collectively, the "Moscovitz Defendants") who conducted the investigation and authored the investigative report requested by the Company's Audit Committee following the discovery of alleged improprieties at the Company's Asian subsidiaries. The claims against the Company's former outside legal counsel are for breach of fiduciary duty and professional negligence. In addition to these claims, the Amended Complaint contains a claim of civil conspiracy against Ernst & Young LLP, Greenberg Traurig and Mr. Schwimmer.

On September 22, 2009, the Court granted Ernst & Young LLP's motion to compel arbitration and to stay all Circuit Court proceedings between Ernst & Young LLP and the Company. Pursuant to an Agreed Order in August 2010, Ernst & Young-Hong Kong L.P. joined the arbitration and the Circuit Court action against it was stayed. A final hearing before the arbitration panel was completed on May 27, 2011 and a binding decision is expected during in the Fall of 2011.

The Company and the Defendants in the Circuit Court proceeding are continuing to engage in written discovery and oral depositions. On July 11, 2011, defendants Jenkins & Gilchrist, the Moscovitz Defendants and Bilzin Sumberg filed a counterclaim in the Circuit Court of the 15th Judicial Circuit in and for Palm Beach County, Florida against the Company and a Third Party Complaint against its President and Chief Executive Officer, Mark Emalfarb, individually. On September 9, 2011, the Moscovitz Defendants dropped their sole claim for abuse of process. On the same date, Jenkins & Gilchrist and Bilzin Sumberg filed an amended counterclaim against the Company and Mark Emalfarb for common law indemnity. Jenkins & Gilchrist has also made a claim against the Company for breach of the implied covenant of good faith and fair dealing. Bilzin Sumberg dropped its claim for abuse of process and has made claims against the Company and Mark Emalfarb for breach of its retainer agreements and for declaratory relief. The Company believes these claims are baseless and without merit and will vigorously defend against them.

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 4: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Pending Actions (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 his termination for cause pursuant to his employment agreement dated as of April 1, 2001 (as amended, the "Employment Agreement"). This arbitration action asserts, 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. The Company's primary and excess insurance carriers denied coverage for the Emalfarb Arbitration based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies. In consideration for the contribution by the insurance carriers to the resolution of the Class Action Litigation (as defined below), all pending claims with such insurance carriers with respect to the Emalfarb Arbitration were released. This arbitration is currently stayed indefinitely but may be re-initiated by Mr. Emalfarb at any time.

Resolved Actions

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 September 27, 2008, Capital Max filed an Amended and Consolidated Class Action Complaint on behalf of all persons who purchased or acquired the Company's securities during the period of October 29, 2004 through April 23, 2007 (the "Class Period") against the Company and the following current and former officers and directors of the Company: Richard J. Berman, Mark A. Emalfarb, Rufus Gardner, Wayne Moor, Harry Z. Rosengart and Stephen J. Warner (collectively, the "Defendants"). Capital Max alleged violations of Section 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78j(b) and 78t(a) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, based on the alleged failure of the Defendants to disclose in statements to the SEC and to the investing public actual occurrences and risk of financial and operational improprieties by the Company's Asian subsidiaries during the Class Period.

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

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 4: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Resolved Actions (Continued)

Class Action Stockholder Lawsuit (Continued)

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. The Company's primary and excess insurance carriers denied coverage for the Class Action Litigation based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies. In consideration for the contribution by the insurance carriers to the resolution of the Class Action Litigation, all pending claims with such insurance carriers with respect to the Class Action Litigation were released.

On April 16, 2010, the parties to the Class Action Litigation filed a Stipulation of Settlement with the Court which provided for payment to the alleged class of \$4.8 million of which \$2.8 million was funded by the Company and \$2.0 million was funded by its insurance carriers. The Stipulation of Settlement was primarily approved by the Court on April 20, 2010 and finally approved on July 27, 2010 which resulted in the dismissal of the Class Action Litigation with prejudice.

Indemnification Demands

In August 2008, the Company received the first of several written demands from legal counsel representing the Company's former directors, Wayne Moor, Harry Z. Rosengart and Richard J. Berman, for advancement and indemnification of their legal expenses relating to the Class Action Litigation and the SEC Action. The Company's primary and excess insurance carriers denied coverage for the Class Action Litigation and the SEC Action based on their interpretation of exclusions and assertion of other coverage defenses contained in the Company's insurance policies. In consideration for the contributions by the insurance carriers to the resolution of the Class Action Litigation described above, all pending claims with such insurance carriers with respect to the Class Action Litigation were released. On April 23, 2010, the Company paid the remaining legal fees and costs of Messrs. Moor, Rosengart and Berman of approximately \$135,000, agreed to pay their reasonable attorneys' fees and costs to finalize the settlement of the Class Action Litigation up to a maximum of \$25,000, and executed mutual releases with them covering the matters for which Messrs. Moor, Rosengart and Berman and the Company released the insurance carriers.

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 had no obligation to provide coverage for the Class Action Litigation. The coverage at issue was an excess policy to the Company that covered the time period from October 27, 2006 to October 27, 2007. The excess carrier denied coverage for the Class Action Litigation based on its interpretation of exclusions contained in the Company's insurance policy.

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 4: Commitments and Contingencies (Continued)

Litigation, Claims and Assessments (Continued)

Resolved Actions (Continued)

On July 29, 2009, the Court granted the Insurance Defendants' motion to stay the action indefinitely. As a result of the final approval of the resolution of the Class Action Litigation by the Court on July 27, 2010, this action was dismissed with prejudice on November 4, 2010.

Other

In addition to the matters noted above, from time to time, the Company is subject to legal proceedings, asserted claims and investigations in the ordinary course of business, including commercial claims, employment and other matters, which management considers immaterial, individually and in the aggregate. The Company makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Litigation is inherently unpredictable and costly. While the Company believes that it has valid defenses with respect to the legal matters pending against it, protracted litigation and/or an unfavorable resolution of one or more of such proceedings, claims or investigations against the Company could have a material adverse effect on the Company's consolidated financial position, cash flows or results of operations.

Note 5: Common Stock

Issuances of Common Stock

During the nine months ended September 30, 2011, stock options to purchase 189,375 shares of common stock were exercised at an average exercise price of \$0.19 per share. Cash received from stock options exercised during the nine months was approximately \$34,800.

During the nine months ended September 30, 2011, warrants to purchase 100,000 shares of common stock were exercised at an exercise price of \$0.15 per share. Cash received from warrants exercised during the nine months was \$15,000.

Note 6: Share-Based Compensation

On February 28, 2011, the Company granted to its employees and Key Advisors (as defined under its 2006 Stock Option Plan) options to purchase 150,000 and 1,019,500 shares of the Company's common stock at an exercise price of \$2.12 and \$1.93, respectively, per share. The stock options vest over four years and expire on February 27, 2016 and 2021, respectively. The fair market value of such stock options was \$1.80 and \$1.73, respectively, based on the Black-Scholes valuation model. Assumptions used in the Black-Scholes valuation model for stock options granted were as follows:

Average Risk-Free Interest Rate	3.42%
Dividend Yield	0.00%
Average Volatility Factor	124.022%
Average Option Life	5 - 6.5 years

DYADIC INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 6: Share-Based Compensation (Continued)

There were 52,000 stock options that expired or were cancelled during the nine months ended September 30, 2011. As of September 30, 2011, there were stock options outstanding under the Company's equity plans to purchase 4,026,500 shares of common stock.

The Company recognized non-cash share-based compensation expense for its share-based awards of approximately \$410,000 and \$243,000 for the three months ended September 30, 2011 and 2010, respectively, and approximately \$1,068,000 and \$668,000 for the nine months ended September 30, 2011 and 2010, respectively. These charges had no impact on the Company's reported cash flows. Total non-cash share-based compensation expense was allocated among the following expense categories:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2011	2010	2011	2010
General and administrative	\$ 685,751	\$ 514,475	\$ 227,424	180,600
Research and development	148,719	31,156	92,844	10,475
Cost of goods sold	90,036	49,525	34,015	15,333
Sales and marketing	143,868	72,998	55,407	36,714
	<u>\$ 1,068,374</u>	<u>\$ 668,154</u>	<u>\$ 409,690</u>	<u>243,122</u>

The Dyadic International, Inc. 2011 Equity Incentive Award Plan (the "2011 Plan") was adopted by the Company's Board of Directors on April 28, 2011, and approved by the its stockholders on June 15, 2011. Dyadic also maintains the Dyadic International, Inc. 2006 Stock Option Plan (the "2006 Stock Option Plan") which may be used for grants of equity awards to employees, consultants and/or directors in accordance with its terms. As a result of the prior termination of the Dyadic International, Inc. 2001 Equity Compensation Plan, as amended, no additional grants of equity awards will be made under that plan. All outstanding stock awards granted under the 2006 Stock Option Plan will continue to be subject to the terms and conditions set forth in the agreements evidencing such stock awards and the terms of the 2006 Stock Option Plan and shall be unaffected by the approval of the 2011 Plan by our stockholders.

The principal purpose of the 2011 Plan is to attract, retain and motivate selected employees, consultants and directors through the granting of stock-based compensation awards and cash-based performance bonus awards. The 2011 Plan is also designed to permit the Company to make cash-based awards and equity-based awards intended to qualify as "performance-based compensation" under Section 162(m) of the Internal Revenue Code of 1986, as amended.

Under the 2011 Plan, 3,000,000 shares of our common stock has been initially reserved for issuance pursuant to a variety of stock-based compensation awards, including stock options, stock appreciation rights ("SARs"), restricted stock awards, restricted stock unit awards, deferred stock awards, dividend equivalent awards, stock payment awards and performance awards and other stock-based awards, in addition to the number of shares remaining available for future awards under our 2006 Stock Option Plan. The number of shares initially reserved for issuance or transfer pursuant to awards under the 2011 Plan will be increased by (i) any shares available for issuance under the 2006 Stock Option Plan or are subject to awards under the 2006 Stock Option Plan that are forfeited or lapse unexercised and which following the effective date of the Plan are not issued under the 2006 Stock Option Plan and (ii) an annual increase on the first day of each fiscal year beginning in 2012 and ending in 2021, equal to either 1,500,000 shares or such smaller number of shares of stock as determined by our Board of Directors.

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Note 7: Income Taxes

As of September 30, 2011, the Company had significant net operating loss carry forwards remaining that expire beginning in 2022. The Company has determined that a full valuation allowance against its net deferred taxes is necessary as of September 30, 2011.

The Company is subject to income taxes in the U.S. federal jurisdiction, various state jurisdictions and certain other international jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. The Company is not subject to U.S. federal, state and local tax examinations by tax authorities for the years before 2006. If the Company were to subsequently record an unrecognized tax benefit, associated penalties and tax related interest expense would be reported as a component of income tax expense.

Note 8: Segment Data Information

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

	Nine Months Ended September 30, 2011		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 6,509,082	\$ 1,349,985	\$ 7,859,067
Income (Loss) from Operations	(3,300,792)	78,451	(3,222,341)
Interest Income	5,193	3,195	8,388
Interest Expense	(342,872)	-	(342,872)
Stock Based Compensation	(886,590)	(181,784)	(1,068,374)
Capital Expenditures	-	(80,412)	(80,412)
Depreciation and Amortization	(87,920)	(128,883)	(216,803)
Total Assets	8,451,483	1,276,052	9,727,535

	Nine Months Ended September 30, 2010		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 5,623,483	\$ 567,701	\$ 6,191,184
(Loss) from Operations	(4,045,272)	(39,028)	(4,084,300)
Interest Income	42,183	3,820	46,003
Interest Expense	(132,657)	-	(132,657)
Stock Based Compensation	(564,421)	(103,733)	(668,154)
Capital Expenditures	-	(166,446)	(166,446)
Depreciation and Amortization	(120,573)	(121,891)	(242,464)
Total Assets	10,517,874	1,040,891	11,558,765

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Note 8: Segment Data Information (Continued)

	Three Months Ended September 30, 2011		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 2,039,528	\$ 535,883	\$ 2,575,411
(Loss) from Operations	(1,263,453)	60,172	(1,203,281)
Interest Income	563	1,151	1,714
Interest Expense	(116,135)	-	(116,135)
Stock Based Compensation	(338,520)	(71,170)	(409,690)
Capital Expenditures	-	(3,493)	(3,493)
Depreciation and Amortization	(18,191)	(45,059)	(63,250)

	Three Months Ended September 30, 2010		
	U.S. Operating Segment	Netherlands Operating Segment	Total
Net Revenue	\$ 1,948,571	\$ 38,101	\$ 1,986,672
Income (Loss) from Operations	(1,499,311)	317,394	(1,181,917)
Interest Income	8,346	1,646	9,992
Interest Expense	(67,591)	-	(67,591)
Stock Based Compensation	(208,164)	(34,958)	(243,122)
Capital Expenditures	-	(9,131)	(9,131)
Depreciation and Amortization	(40,093)	(44,207)	(84,300)

Note 9: Subsequent Events

The Company has evaluated these unaudited interim condensed consolidated financial statements for subsequent events through November 3, 2011, the date of issuance of these financial statements.