

LANDEC CORP \CA\  
Form 10-Q  
October 06, 2008

United States  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**For the Fiscal Quarter Ended August 31, 2008, or**

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: **0-27446**

**LANDEC CORPORATION**

(Exact name of registrant as specified in its charter)

**California**  
(State or other jurisdiction of  
incorporation or organization)

**94-3025618**  
(IRS Employer  
Identification Number)

**3603 Haven Avenue**  
**Menlo Park, California 94025**  
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code:  
**(650) 306-1650**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer" and "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer   
Non Accelerated Filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of September 19, 2008, there were 26,166,319 shares of Common Stock outstanding.

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**LANDEC CORPORATION**

FORM 10-Q For the Fiscal Quarter Ended August 31, 2008

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**LANDEC CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands except shares and per share amounts)

|  | August 31,<br>2008<br>(Unaudited) | May 25,<br>2008<br>(1) |
|--|-----------------------------------|------------------------|
| <b>ASSETS</b>  |                                   |                        |
| Current Assets:  |                                   |                        |
| Cash and cash equivalents  | \$ 45,747                         | \$ 44,396              |
| Marketable securities  | 16,256                            | 14,643                 |
| Accounts receivable, less allowance for doubtful accounts of \$214 and \$169 at August 31, 2008 and May 25, 2008, respectively   | 18,657                            | 19,460                 |
| Accounts receivable, related party   | 407                               | 411                    |
| Inventories, net   | 8,181                             | 7,329                  |
| Notes and advances receivable  | 356                               | 501                    |
| Deferred taxes   | 2,180                             | 2,180                  |
| Prepaid expenses and other current assets  | 805                               | 1,746                  |
| <b>Total Current Assets</b>  | <b>92,589</b>                     | <b>90,666</b>          |
| Property and equipment, net  | 21,384                            | 21,306                 |
| Goodwill, net  | 27,354                            | 27,354                 |
| Trademarks, net  | 8,228                             | 8,228                  |
| Other assets   | 3,234                             | 3,035                  |
| <b>Total Assets</b>  | <b>\$ 152,789</b>                 | <b>\$ 150,589</b>      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                   |                        |
| Current Liabilities:   |                                   |                        |
| Accounts payable   | \$ 18,061                         | \$ 18,991              |
| Related party accounts payable   | 377                               | 273                    |
| Income taxes payable   | 427                               | —                      |
| Accrued compensation   | 1,362                             | 2,197                  |
| Other accrued liabilities  | 2,732                             | 2,930                  |
| Deferred revenue   | 2,761                             | 3,613                  |
| <b>Total Current Liabilities</b>   | <b>25,720</b>                     | <b>\$ 28,004</b>       |
| Deferred revenue   | 4,500                             | 5,000                  |
| Deferred taxes   | 1,569                             | 1,569                  |
| Minority interest  | 1,714                             | 1,550                  |
| <b>Total Liabilities</b>   | <b>33,503</b>                     | <b>36,123</b>          |
| Shareholders' Equity:  |                                   |                        |
| Common stock, \$0.001 par value; 50,000,000 shares authorized; 26,166,319 and 26,156,323 shares issued and outstanding at August 31, 2008 and May 25, 2008, respectively | 114,955                           | 112,974                |
| Retained earnings  | 4,331                             | 1,492                  |
| <b>Total Shareholders' Equity</b>  | <b>119,286</b>                    | <b>114,466</b>         |
| <b>Total Liabilities and Shareholders' Equity</b>  | <b>\$ 152,789</b>                 | <b>\$ 150,589</b>      |

(1) Derived from audited financial statements.

*See accompanying notes.*

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**LANDEC CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(In thousands, except per share amounts)

|   | Three Months Ended |                    |
|---|--------------------|--------------------|
|   | August 31,<br>2008 | August 26,<br>2007 |
| <b>Revenues:</b>                            |                    |                    |
| Product sales                               | \$ 68,861          | \$ 59,800          |
| Services revenue, related party             | 1,158              | 1,075              |
| License fees                                | 1,550              | 1,581              |
| Research, development and royalty revenues  | 184                | 171                |
| Royalty revenues, related party             | —                  | 32                 |
| <b>Total revenues</b>                       | <b>71,753</b>      | <b>62,659</b>      |
| <b>Cost of revenue:</b>                     |                    |                    |
| Cost of product sales                       | 59,302             | 51,592             |
| Cost of product sales, related party        | 1,437              | 1,212              |
| Cost of services revenue                    | 891                | 881                |
| <b>Total cost of revenue</b>                | <b>61,630</b>      | <b>53,685</b>      |
| <b>Gross profit</b>                         | <b>10,123</b>      | <b>8,974</b>       |
| <b>Operating costs and expenses:</b>        |                    |                    |
| Research and development                    | 888                | 822                |
| Selling, general and administrative         | 4,676              | 4,546              |
| <b>Total operating costs and expenses</b>   | <b>5,564</b>       | <b>5,368</b>       |
| <b>Operating income</b>                     | <b>4,559</b>       | <b>3,606</b>       |
| Interest income                             | 357                | 781                |
| Interest expense                            | (2)                | (8)                |
| Minority interest expense                   | (164)              | (120)              |
| <b>Net income before taxes</b>              | <b>4,750</b>       | <b>4,259</b>       |
| <b>Income tax expense</b>                   | <b>(1,911)</b>     | <b>(1,182)</b>     |
| <b>Net income</b>                           | <b>\$ 2,839</b>    | <b>\$ 3,077</b>    |
| <b>Basic net income per share</b>           |                    |                    |
|   | <b>\$ 0.11</b>     | <b>\$ 0.12</b>     |
| <b>Diluted net income per share</b>         |                    |                    |
|   | <b>\$ 0.11</b>     | <b>\$ 0.11</b>     |
| <b>Shares used in per share computation</b> |                    |                    |
| Basic                                       | 26,163             | 25,937             |
| Diluted                                     | 26,799             | 26,911             |

*See accompanying notes.*

**LANDEC CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(in thousands)

|  | Three months Ended |                    |
|--|--------------------|--------------------|
|  | August 31,<br>2008 | August 26,<br>2007 |
| <b>Cash flows from operating activities:</b>                                       |                    |                    |
| Net income   | \$ 2,839           | \$ 3,077           |
| <b>Adjs. to reconcile net income to net cash provided by operating activities:</b> |                    |                    |
| Depreciation and amortization  | 796                | 716                |
| Stock-based compensation expense   | 295                | 325                |
| Tax benefit from stock-based compensation expense                                  | (1,686)            |                    |
| Increase in long-term receivable   | (200)              | (200)              |
| Minority interest  | 164                | 120                |
| <b>Changes in current assets and current liabilities:</b>                          |                    |                    |
| Accounts receivable, net   | 803                | (12)               |
| Accounts receivable, related party   | 4                  | (64)               |
| Inventories, net   | (852)              | (1,000)            |
| Issuance of notes and advances receivable  | (233)              | (2)                |
| Collection of notes and advances receivable  | 379                | 141                |
| Prepaid expenses and other current assets  | 941                | (242)              |
| Accounts payable   | (930)              | 2,554              |
| Related party accounts payable   | 104                | 291                |
| Income taxes payable   | 2,113              | 24                 |
| Accrued compensation   | (835)              | (1,902)            |
| Other accrued liabilities  | (198)              | 291                |
| Deferred revenue   | (1,352)            | (1,293)            |
| Net cash provided by operating activities  | 2,152              | 2,824              |
| <b>Cash flows from investing activities:</b>                                       |                    |                    |
| Purchases of property and equipment  | (874)              | (236)              |
| Issuance of notes and advances receivable  | (1)                | (4)                |
| Purchase of marketable securities  | (7,013)            | —                  |
| Proceeds from maturities of marketable securities                                  | 5,400              | —                  |
| Net cash used in investing activities  | (2,488)            | (240)              |
| <b>Cash flows from financing activities:</b>                                       |                    |                    |
| Proceeds from sale of common stock   | —                  | 570                |
| Repurchase of subsidiary common stock and options                                  | —                  | (20,596)           |
| Tax benefit from stock-based compensation expense                                  | 1,686              | 1,132              |
| Decrease in other assets   | 1                  | 4                  |
| Issuance of related party note payable   | —                  | 232                |
| Payments on long term debt   | —                  | (5)                |
| Payments to minority interest holders  | —                  | (227)              |
| Net cash provided by (used in) financing activities                                | 1,687              | (18,890)           |
| Net decrease in cash and cash equivalents  | 1,351              | (16,306)           |
| Cash and cash equivalents at beginning of period                                   | 44,396             | 62,556             |
| Cash and cash equivalents at end of period   | \$ 45,747          | \$ 46,250          |



Supplemental schedule of noncash operating activities:

|   |    |       |    |       |
|---|----|-------|----|-------|
| Income tax expense not payable                                    | \$ | 1,686 | \$ | 1,132 |
| Long-term receivable from Monsanto for guaranteed termination fee | \$ | 200   | \$ | 200   |

*See accompanying notes.*

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. Organization, Basis of Presentation and Summary of Significant Accounting Policies**

**Organization**

Landec Corporation and its subsidiaries ("Landec" or the "Company") design, develop, manufacture, and sell temperature-activated and other specialty polymer products for a variety of food products, agricultural products, and licensed partner applications. The Company sells Intellicoat® coated seed products through its Landec Ag, Inc. ("Landec Ag") subsidiary and specialty packaged fresh-cut vegetables and whole produce to retailers and club stores, primarily in the United States and Asia through its Apio, Inc. ("Apio") subsidiary.

**Basis of Presentation**

The accompanying unaudited consolidated financial statements of Landec have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made which are necessary to present fairly the financial position at August 31, 2008 and the results of operations and cash flows for all periods presented. Although Landec believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in financial statements and related footnotes prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted per the rules and regulations of the Securities and Exchange Commission. The accompanying financial data should be reviewed in conjunction with the audited financial statements and accompanying notes included in Landec's Annual Report on Form 10-K for the fiscal year ended May 25, 2008.

The results of operations for the three months ended August 31, 2008 are not necessarily indicative of the results that may be expected for an entire fiscal year due to some seasonality in Apio's food business and because the first quarter of fiscal year 2009 was a 14-week quarter which occurs once every five years compared to the standard 13-week quarter.

**Basis of Consolidation**

The consolidated financial statements are presented on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles and include the accounts of Landec Corporation and its subsidiaries, Apio and Landec Ag. All material inter-company transactions and balances have been eliminated.

The Company follows FASB Interpretation No. 46R, "*Consolidation of Variable Interest Entities*" ("FIN 46R"), which addresses the consolidation of variable interest entities ("VIEs"). Under FIN 46R, arrangements that are not controlled through voting or similar rights are accounted for as VIEs. An enterprise is required to consolidate a VIE if it is the primary beneficiary of the VIE.

Under FIN 46R, a VIE is created when (i) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (ii) the entity's equity holders as a group either: (a) lack direct or indirect ability to make decisions about the entity through voting or similar rights, (b) are not obligated to absorb expected losses of the entity if they occur, or (c) do not have the right to receive expected residual returns of the entity if they occur. If an entity is deemed to be a VIE pursuant to FIN 46R, the enterprise that is deemed to absorb a majority of the expected losses or receive a majority of expected residual returns

of the VIE is considered the primary beneficiary and must consolidate the VIE.

Based on the provisions of FIN 46R, the Company has concluded that as a result of the license and supply agreement between Landec and Monsanto Company (see Note 2), Monsanto has a variable interest in the Company's Intellicoat coating subsidiary, Landec Ag, and therefore Landec Ag has been determined to be a VIE. The Company has also determined that it is the primary beneficiary of Landec Ag and therefore the accounts of Landec Ag are consolidated with the accounts of the Company.

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## **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make certain estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. The accounting estimates that require management's most significant, difficult and subjective judgments include revenue recognition; sales returns and allowances; recognition and measurement of current and deferred income tax assets and liabilities; the assessment of recoverability of long-lived assets; the valuation of intangible assets and inventory; the valuation and nature of impairments of investments; and the valuation and recognition of stock-based compensation.

These estimates involve the consideration of complex factors and require management to make judgments. The analysis of historical and future trends, can require extended periods of time to resolve, and are subject to change from period to period. The actual results may differ from management's estimates.

For instance, the carrying value of notes and advances receivable, are impacted by current market prices for the related crops, weather conditions and the fair value of the underlying security obtained by the Company, such as, liens on property and crops. The Company recognizes losses when it estimates that the fair value of the related crops or security is insufficient to cover the advance or note receivable.

## **Cash, Cash Equivalents and Marketable Securities**

The Company records all highly liquid securities with three months or less from date of purchase to maturity as cash equivalents and consists mainly of certificate of deposits, money market funds and U.S. Treasuries. Short-term marketable securities consist of certificates of deposit that are FDIC insured with original maturities of more than three months at the date of purchase and less than one year from the date of the balance sheet. The Company classifies all debt securities with readily determined market values as "available for sale" in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." These investments are classified as marketable securities on the consolidated balance sheet as of August 31, 2008 and are carried at fair market value. Unrealized gains and losses are reported as a component of shareholders' equity and were not significant in for the three months ended August 31, 2008. The cost of debt securities is adjusted for amortization of premiums and discounts to maturity. This amortization is recorded to interest income. Realized gains and losses on the sale of available-for-sale securities are also recorded to interest income and were not significant for the three months ended August 31, 2008. The cost of securities sold is based on the specific identification method.

## **Financial Instruments**

The Company's financial instruments are primarily composed of marketable debt securities, commercial-term trade payables and grower advances, and notes receivable, as well as long-term notes receivables and debt instruments. For short-term instruments, the historical carrying amount is a reasonable estimate of fair value. Fair values for long-term financial instruments not readily marketable are estimated based upon discounted future cash flows at prevailing market interest rates. Based on these assumptions, management believes the fair market values of the Company's financial instruments are not materially different from their recorded amounts as of August 31, 2008.

## **Investments**

Equity investments in non-public companies with no readily available market value are carried on the balance sheet at cost as adjusted for impairment losses, if any. If reductions in the market value of the investments to an amount that is below cost are deemed by management to be other than temporary, the reduction in market value will be realized, with the resulting loss in market value reflected on the income statement.



## Recent Accounting Pronouncements

### *Fair Value Measurements*

In September 2006, FASB issued SFAS No. 157, “*Fair Value Measurements.*” SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 does not require new fair value measurements but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of information. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. However, on February 12, 2008, the FASB issued FASB Staff (“FSP”) FAS No. 157-2 which delays the effective date for all non-financial assets and liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP 157- 2 defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within the fiscal years for items within the scope of this FSP. The Company adopted SFAS No. 157 on May 26, 2008 for financial assets and financial liabilities. It did not have any impact on the Company’s results of operations or financial position for the three months ended August 31, 2008. The Company will adopt Statement 157 for non-financial assets and liabilities during its fiscal year ending May 30, 2010.

In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities— Including an amendment of FASB Statement No. 115.*” SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Subsequent adjustments to the fair value of the financial instruments and liabilities an entity elects to carry at fair value will be recognized in earnings. SFAS No. 159 also establishes additional disclosure requirements. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted provided the entity also elects to apply the provisions of SFAS No. 157. The Company adopted SFAS No. 159 on May 26, 2008, but has not elected the fair value measurement provisions for any eligible financial statements.

### *Business Combinations*

The FASB issued SFAS No. 141R (revised 2007), “*Business Combinations.*” which significantly changes the financial accounting and reporting for business combination transactions. SFAS No. 141R requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction and establishes the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of this standard will, among other things, impact the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration); exclude transaction costs from acquisition accounting; and change accounting practices for acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. For the Company, SFAS No. 141R is effective for business combinations occurring after May 31, 2009. The Company is currently evaluating the future impacts and disclosures of this standard.

### *Noncontrolling Interests*

In December 2007, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 160, “*Noncontrolling Interests in Consolidated Financial Statements.*” SFAS No. 160 amends Accounting Research Bulletin (“ARB”) No. 51, “*Consolidated Financial Statements*” and establishes accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary. This statement requires the reporting of all noncontrolling interests as a separate component of stockholders’ equity, the reporting of consolidated net income (loss) as the amount attributable to both the parent and the noncontrolling interests and the separate disclosure of net income (loss) attributable to the parent and to the noncontrolling interests. In addition, this statement provides accounting and reporting guidance related to changes in noncontrolling ownership interests. Other than the reporting requirements described above which require retrospective application, the provisions of SFAS No. 160 are to be applied prospectively in the first annual reporting

period beginning on or after December 15, 2008. The Company is currently in the process of determining the impact and disclosure of this standard and expects it will result in a reclassification of income from the noncontrolling interest (minority interest) in Apio Cooling, L.P., in which Apio is the general partner with a 60% ownership position. Upon adoption, all noncontrolling interest will be included as a component of stockholders' equity and not in the statement of operations. The Company does not anticipate any additional material impact on the consolidated financial statements.

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### *Collaborative Arrangements*

In December 2007, the FASB ratified the EITF consensus on EITF Issue No. 07-1, “*Accounting for Collaborative Arrangements*” that discusses how parties to a collaborative arrangement (which does not establish a legal entity within such arrangement) should account for various activities. The consensus indicates that costs incurred and revenues generated from transactions with third parties (i.e. parties outside of the collaborative arrangement) should be reported by the collaborators on the respective line items in their income statements pursuant to EITF Issue No. 99-19, “*Reporting Revenue Gross as a Principal Versus Net as an Agent.*” Additionally, the consensus provides that income statement characterization of payments between the participants in a collaborative arrangement should be based upon existing authoritative pronouncements; analogy to such pronouncements if not within their scope; or a reasonable, rational, and consistently applied accounting policy election. For the Company, EITF Issue No. 07-1 is effective beginning June 1, 2009 and is to be applied retrospectively to all periods presented for collaborative arrangements existing as of the date of adoption. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

### **Fair Value Measurements**

The Company adopted Statement 157 on May 26, 2008 for financial assets and liabilities. The Company also adopted Statement 159 in which entities are permitted to choose to measure many financial instruments and certain other items at fair value. The Company did not elect the fair value option for any of its eligible financial assets or liabilities under SFAS 159.

SFAS No. 157 established a three-tier hierarchy for fair value measurements, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 – observable inputs such as quoted prices for identical instruments in active markets.
- Level 2 – inputs other than quoted prices in active markets that are observable either directly or indirectly through corroboration with observable market data.
- Level 3 – unobservable inputs in which there is little or no market data, which would require the Company to develop its own assumptions.

As of August 31, 2008, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company’s cash equivalents and marketable securities for which the fair value is determined based on observable inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized the cash equivalents and marketable securities as Level 1. The Company has no other financial assets or liabilities for which fair value measurement has been adopted.

### **Reclassifications**

Certain reclassifications have been made to prior period financial statements to conform to the current period presentation.

## **2. License Agreement with Monsanto Company**

On December 1, 2006, Landec sold its direct marketing and sales seed company, Fielder’s Choice Direct (“FCD”), which included the Fielder’s Choice Direc<sup>®</sup> and Heartland Hybrid<sup>®</sup> brands, to American Seeds, Inc., a wholly owned subsidiary of Monsanto Company (“Monsanto”). The acquisition price for FCD was \$50 million in cash paid at the close. During fiscal year 2007, Landec recorded income from the sale, net of direct expenses and bonuses, of \$22.7



million. The income that was recorded is equal to the difference between the fair value of FCD of \$40 million and its net book value, less direct selling expenses and bonuses. In accordance with generally accepted accounting principles, the portion of the \$50 million of proceeds in excess of the fair value of FCD, or \$10 million, was allocated to the technology license agreement described below and will be recognized as revenue ratably over the five year term of the technology license agreement or \$2 million per year beginning December 1, 2006. The fair value was determined by management.

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On December 1, 2006, Landec also entered into a five-year co-exclusive technology license and polymer supply agreement (“the Agreement”) with Monsanto for the use of Landec’s Intellicoat polymer seed coating technology. Under the terms of the Agreement, Monsanto will pay Landec Ag \$2.6 million per year in exchange for (1) a co-exclusive right to use Landec’s Intellicoat temperature-activated seed coating technology worldwide during the license period, (2) the right to be the exclusive global sales and marketing agent for the Intellicoat seed coating technology, and (3) the right to purchase the stock of Landec Ag at any time during the five year term of the Agreement. Monsanto will also fund all operating costs, including all Intellicoat research and development, product development and non-replacement capital costs during the five year agreement period. For each of the three months ended August 31, 2008 and August 26, 2007, Landec recognized \$1.35 million in revenues from the Agreement.

The Agreement also provides for a fee payable to Landec Ag of \$4 million if Monsanto elects to terminate the agreement or \$8 million if Monsanto elects to purchase the stock of Landec Ag. If the purchase option is exercised before the fifth anniversary of the Agreement, or if Monsanto elects to terminate the Agreement, all annual license fees and supply payments that have not been paid to Landec Ag will become due upon the purchase. If Monsanto does not exercise its purchase option by the fifth anniversary of the Agreement, Landec Ag will receive the termination fee and all rights to the Intellicoat seed coating technology will revert to Landec. Accordingly, Landec Ag will receive minimum guaranteed payments of \$17 million for license fees and polymer supply payments over five years or \$21 million in maximum payments if Monsanto elects to purchase the stock of Landec Ag. The minimum guaranteed payments and the deferred gain of \$2 million per year described above will result in Landec recognizing revenue and operating income of \$5.4 million per year for fiscal years 2008 through 2011 and \$2.7 million per year for fiscal years 2007 and 2012. The incremental \$4 million to be received in the event Monsanto exercises the purchase option has been deferred and will be recognized upon the exercise of the purchase option. The fair value of the purchase option was determined by management to be less than the amount of the deferred revenue.

If Monsanto elects to purchase the stock of Landec Ag, a gain or loss on the sale of the stock of Landec Ag will be recognized at the time of purchase. If Monsanto exercises its purchase option, Landec and Monsanto will enter into a new long-term supply agreement in which Landec will continue to be the exclusive supplier of Intellicoat polymer materials to Monsanto.

### 3. Stock-Based Compensation

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard to (i) all stock-based awards issued on or after May 29, 2006 and (ii) any outstanding stock-based awards that were issued but not vested as of May 29, 2006. In the three months ended August 31, 2008, the Company recognized stock-based compensation expense of \$295,000 or \$0.01 per basic and diluted share, which included \$79,000 for restricted stock unit awards and \$216,000 for stock option grants. In the three months ended August 26, 2007, the Company recognized stock-based compensation expense of \$325,000 or \$0.01 per basic and diluted share, which included \$63,000 for restricted stock unit awards and \$262,000 for stock option grants.

The following table summarizes the stock-based compensation by income statement line item:

|                                       | <b>Three Months<br/>Ended<br/>August 31, 2008</b> | <b>Three Months<br/>Ended<br/>August 26, 2007</b> |
|---------------------------------------|---|---|
| Research and development              | \$ 42,000   | \$ 32,000   |
| Sales, general and administrative     | 253,000   | 293,000   |
| <b>Total stock-based compensation</b> | <b>\$ 295,000</b>                                 | <b>\$ 325,000</b>                                 |

As of August 31, 2008, there was \$945,000 of total unrecognized compensation expense related to unvested equity compensation awards granted under the Landec incentive stock plans. Total expense is expected to be recognized over

the weighted-average period of 1.72 years.

During the three months ended August 31, 2008, the Company granted options to purchase 75,000 shares of common stock and 25,002 restricted stock unit awards.

As of August 31, 2008 the Company has reserved 2.5 million shares of Common Stock for future issuance under its current and former stock plans.

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#### 4. Net Income Per Diluted Share

The following table sets forth the computation of diluted net income for the periods with net income (in thousands, except per share amounts):

|  | Three Months<br>Ended<br>August 31, 2008 | Three Months<br>Ended<br>August 26, 2007 |
|--|--|--|
| Numerator:   |  |  |
| Net income   | \$ 2,839                                 | \$ 3,077                                 |
| Denominator:   |  |  |
| Weighted average shares for basic net income per share   | 26,163                                   | 25,937                                   |
| Effect of dilutive securities:                           |  |  |
| Stock options and restricted stock units                 | 636                                      | 974                                      |
| Weighted average shares for diluted net income per share | 26,799                                   | 26,911                                   |
| Diluted net income per share                             | \$ 0.11                                  | \$ 0.11                                  |

For the three months ended August 31, 2008 and August 26, 2007, the computation of the diluted net income per share excludes the impact of options to purchase 245,579 shares and 68,901 shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

#### 5. Income Taxes

The estimated annual effective tax rate for fiscal 2009 is currently expected to be approximately 40%. The provision for income taxes for the three months ended August 31, 2008 was \$1.9 million.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, “*Accounting for Uncertainty in Income Taxes*” (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with Statement of Financial Accounting Standards No. 109, “*Accounting for Income Taxes*” (“FAS 109”). This interpretation prescribes 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. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

As of May 25, 2008, the Company had unrecognized tax benefits of approximately \$678,000. Included in the balance of unrecognized tax benefits as of May 25, 2008 is approximately \$599,000 of tax benefits that, if recognized, would result in an adjustment to the Company’s effective tax rate. The Company does not expect that the amounts of unrecognized tax benefits will change significantly within the next twelve months.

In accordance with FIN 48, paragraph 19, the Company has decided to classify interest and penalties related to uncertain tax positions as a component of its provision for income taxes. Due to the Company’s historical taxable loss position, the Company did not accrue interest and penalties relating to the income tax on the unrecognized tax benefits as of May 25, 2008 and August 31, 2008 as the amounts were not significant.

Due to tax attribute carryforwards, the Company is subject to examination for tax years 1992 forward for U.S. tax purposes. The Company was also subject to examination in various state jurisdictions for tax years 1997 forward, none of which were individually significant.

6.

### **Goodwill and Other Intangibles**

The Company tests goodwill and all its other intangible assets with indefinite lives (collectively, “intangible assets”) for impairment at least annually, in accordance with the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* (“SFAS 142”). When evaluating goodwill for impairment, SFAS 142 requires the Company to first compare the fair value of the reporting unit to its carrying value to determine if there is an impairment loss. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not impaired. Application of the second step of the two-step approach in SFAS 142 is not required. Application of the goodwill impairment tests require significant judgment by management, including identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, determination of the fair value of each reporting unit and projections of future net cash flows, which judgments and projections are inherently uncertain.

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The Company considers the results generated from using both of the approaches set forth in SFAS 142 to estimate the fair value of each relevant reporting unit as follows:

- The Company uses the market approach to develop indications of fair value. This approach uses market values and revenue multiples of other publicly traded companies engaged in the same or similar lines of business as the Company.
- The Company uses the discounted cash flow (“DCF”) methodology to develop an additional estimate of fair value. The DCF methodology recognizes that current value is premised on the expected receipt of future economic benefits. Indications of value are developed by discounting projected future net cash flows to their present value at a rate that reflects both the current return requirements of the market and the risks inherent in the specific investment.

The determination of whether the intangible assets are impaired involves numerous assumptions, estimates and the application of significant judgment. For the market approach, considerable judgment is required to select comparable companies and estimate the multiples of revenues implied by their market values. For the DCF approach, the Company must exercise judgment in selecting an appropriate discount rate and must also make numerous assumptions in order to develop future business and financial forecasts and the related estimates of future net cash flows. Future net cash flows depend primarily on future product sales, which are inherently difficult to predict.

The Company tested its goodwill and other intangible assets with indefinite lives for impairment as of July 20, 2008 and determined that no adjustments to the carrying values of the intangible assets were necessary as of that date. On a quarterly basis, the Company considers the need to update its most recent annual tests for possible impairment of its intangible assets with indefinite lives, based on management’s assessment of changes in its business and other economic factors since the most recent annual evaluation. Such changes, if significant or material, could indicate a need to update the most recent annual tests for impairment of the intangible assets during the current period. The results of these tests could lead to write-downs of the carrying values of the intangible assets in the current period. No such significant or material changes in the Company’s business or economic environment have come to the attention of management since May 25, 2008 through the date of this report.

**7. Inventories**

Inventories are stated at the lower of cost (first-in, first-out method) or market and consisted of the following (in thousands):

|                | August 31,<br>2008 | May 25,<br>2008 |
|----------------|--------------------|-----------------|
| Finished goods | \$ 3,897           | \$ 2,949        |
| Raw material   | 4,284              | 4,380           |
| <b>Total</b>   | <b>\$ 8,181</b>    | <b>\$ 7,329</b> |

**8. Related Party**

Apio provides cooling and distributing services for farms in which the Chairman of Apio (the “Apio Chairman”) has a financial interest and purchases produce from those farms. Apio also purchases produce from Beachside Produce LLC for sale to third parties. Beachside Produce is owned by a group of entities and persons that supply produce to Apio including the Apio Chairman. Revenues and the resulting accounts receivable and cost of product sales and the

resulting accounts payable are classified as related party items in the accompanying financial statements as of August 31, 2008 and May 25, 2008 and for the three months ended August 31, 2008 and August 26, 2007.

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Apio leases, for approximately \$303,000 on a current annual basis, agricultural land that is owned by the Apio Chairman. Apio, in turn, subleases that land at cost to growers who are obligated to deliver product from that land to Apio for value added products. There is generally no net statement of income impact to Apio as a result of these leasing activities but Apio creates a guaranteed source of supply for the value added business. Apio has loss exposure on the leasing activity to the extent that it is unable to sublease the land. For the three months ended August 31, 2008, the Company subleased all of the land leased from the Apio Chairman and received sublease income of \$76,000 which is equal to the amount the Company paid to lease that land for the period.

Apio's domestic commodity vegetable business was sold to Beachside Produce, effective June 30, 2003. The Apio Chairman is a 12.5% owner in Beachside Produce. During the three months ended August 31, 2008 and August 26, 2007, the Company recognized revenues of \$400,000 and \$371,000, respectively, from the sale of products to Beachside Produce. The related accounts receivable from Beachside Produce are classified as related party in the accompanying financial statements as of August 31, 2008 and May 25, 2008.

All related party transactions are monitored quarterly by the Company and approved by the Audit Committee of the Board of Directors.

**9. Comprehensive Loss**

The comprehensive income of Landec is the same as net income.

**10. Shareholders' Equity**

During the three months ended August 31, 2008, 10,002 shares of Common Stock were issued upon the vesting of restricted stock units and upon the exercise of options under the Company's stock option plans.



## 11. Business Segment Reporting

Landec operates in three business segments: the Food Products Technology segment, the Commodity Trading segment and the Technology Licensing segment. The Food Products Technology segment markets and packs specialty packaged whole and fresh-cut vegetables that incorporate the BreatheWay specialty packaging for the retail grocery, club store and food services industry. In addition, the Food Products Technology segment sells BreatheWay packaging to partners for non-vegetable products. The Commodity Trading segment consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia and domestically to Wal-Mart. The Technology Licensing segment licenses Landec's patented Intellicoat seed coatings to the farming industry and licenses the Company's Intelimer polymers for personal care products and other industrial products. Corporate includes corporate general and administrative expenses, non Food Products Technology interest income and Company-wide income tax expenses. All of the assets of the Company are located within the United States of America. Prior to the fourth quarter of 2008, Landec's operating segments were Food Products Technology and Agricultural Seed Technology. At fiscal year end 2008, the Company reexamined its segment reporting. As a result, the Company eliminated the Agricultural Seed Technology segment and established the Commodity Trading and the Technology Licensing segments. As a result, the segment information for first quarter 2008 has been reclassified to conform with the current quarter classification. Included in the Technology Licensing segment for the first quarter 2008 are the results of Landec Ag. In addition, the licensing activity for non food and Ag collaborations is included in the Technology Licensing segment whereas in periods prior to fiscal year 2008 it was included in Corporate. Corporate amounts include corporate general and administrative expenses, non Food Products Technology interest income and Company-wide income taxes. The Company's international sales are primarily to Canada, Taiwan, Indonesia, and Japan. Operations and identifiable assets by business segment consisted of the following (in thousands):

|   | Food Products<br>Technology | Trading   | Technology<br>Licensing | Corporate  | TOTAL     |
|---|-----------------------------|-----------|-------------------------|------------|-----------|
| <b>Three Months Ended August 31, 2008</b> |                             |           |                         |            |           |
| Net sales                                 | \$ 43,814                   | \$ 26,297 | \$ 1,642                | \$ —       | \$ 71,753 |
| International sales                       | \$ 4,147                    | \$ 21,693 | \$ ¾                    | \$ ¾       | \$ 25,840 |
| Gross profit                              | \$ 7,283                    | \$ 1,198  | \$ 1,642                | \$ —       | \$ 10,123 |
| Net income (loss)                         | \$ 3,989                    | \$ 598    | \$ 1,105                | \$ (2,853) | \$ 2,839  |
| Depreciation and amortization             | \$ 744                      | \$ 4      | \$ 48                   | \$ —       | \$ 796    |
| Interest income                           | \$ 122                      | \$ —      | \$ —                    | \$ 235     | \$ 357    |
| Interest expense                          | \$ 2                        | \$ —      | \$ —                    | \$ —       | \$ 2      |
| Income tax expense                        | \$ —                        | \$ —      | \$ —                    | \$ 1,911   | \$ 1,911  |
| <b>Three Months Ended August 26, 2007</b> |                             |           |                         |            |           |
| Net sales                                 | \$ 39,547                   | \$ 21,451 | \$ 1,661                | \$ —       | \$ 62,659 |
| International sales                       | \$ 3,699                    | \$ 19,250 | \$ ¾                    | \$ ¾       | \$ 22,949 |
| Gross profit                              | \$ 6,222                    | \$ 1,091  | \$ 1,661                | \$ —       | \$ 8,974  |
| Net income (loss)                         | \$ 3,103                    | \$ 573    | \$ 1,209                | \$ (1,808) | \$ 3,077  |
| Depreciation and amortization             | \$ 654                      | \$ 5      | \$ 57                   | \$ —       | \$ 716    |
| Interest income                           | \$ 223                      | \$ —      | \$ —                    | \$ 558     | \$ 781    |
| Interest expense                          | \$ 8                        | \$ —      | \$ —                    | \$ ¾       | \$ 8      |
| Income tax expense                        | \$ —                        | \$ —      | \$ —                    | \$ 1,182   | \$ 1,182  |

During each of the three months ended August 31, 2008 and August 26, 2007, sales to the Company's top five customers accounted for 49% of revenues with the Company's top customer from the Food Products Technology segment, Costco Wholesale Corp., accounting for 19% for the three months ended August 31, 2008 and 20% for the three months ended August 26, 2007. The Company expects that, for the foreseeable future, a limited number of

customers may continue to account for a significant portion of its net revenues. The Company's international sales are primarily to Canada, Taiwan, Indonesia and Japan.

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## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with the unaudited consolidated financial statements and accompanying notes included in Part I—Item 1 of this Form 10-Q and the audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in Landec's Annual Report on Form 10-K for the fiscal year ended May 25, 2008.

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Potential risks and uncertainties include, without limitation, those mentioned in this report and, in particular the factors described below under "Additional Factors That May Affect Future Results," and those mentioned in Landec's Annual Report on Form 10-K for the fiscal year ended May 25, 2008. Landec undertakes no obligation to update or revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this report.

### **Critical Accounting Policies and Use of Estimates**

There have been no material changes to the Company's critical accounting policies which are included and described in the Form 10-K for the fiscal year ended May 25, 2008 filed with the Securities and Exchange Commission on August 8, 2008.

### **The Company**

Landec Corporation and its subsidiaries ("Landec" or the "Company") design, develop, manufacture and sell temperature-activated and other specialty polymer products for a variety of food products, agricultural products, and licensed partner applications. This proprietary polymer technology is the foundation, and a key differentiating advantage, upon which Landec has built its business.

Landec's core polymer products are based on its patented proprietary Intelimer polymers, which differ from other polymers in that they can be customized to abruptly change their physical characteristics when heated or cooled through a pre-set temperature switch. For instance, Intelimer polymers can change within the range of one or two degrees Celsius from a non-adhesive state to a highly tacky, adhesive state; from an impermeable state to a highly permeable state; or from a solid state to a viscous state. These abrupt changes are repeatedly reversible and can be tailored by Landec to occur at specific temperatures, thereby offering substantial competitive advantages in Landec's target markets.

Following the sale of Landec's former direct marketing and sales seed corn company, FCD, to Monsanto in fiscal year 2007, Landec now has three core businesses – Food Products Technology, Commodity Trading and Technology Licensing (see note 12 of the unaudited financial statements).

Our Food Products Technology business is operated through a subsidiary, Apio, Inc., and combines our proprietary food packaging technology with the capabilities of a large national food supplier and value-added produce processor. Value-added processing incorporates Landec's proprietary packaging technology with produce that is processed by washing, and in some cases cutting and mixing, resulting in packaged produce to achieve increased shelf life and reduced shrink (waste) and to eliminate the need for ice during the distribution cycle. This combination was consummated in 1999 when the Company acquired Apio, Inc. and certain related entities (collectively, "Apio").

Our Commodity Trading business is operated through Apio and combines Apio's export company, Cal Ex Trading Company ("Cal-Ex") with Apio's domestic buy-sell commodity business that purchases and sells whole fruit and

vegetable products to Asia and domestically to Wal-Mart.

Our Technology Licensing business includes our proprietary Intellicoat seed coating technology which we have licensed to Monsanto and our Intelimer polymer business that licenses and/or supplies products outside of our Food Products Technology business to companies such as Air Products and Chemicals, Inc. (“Air Products”) and Nitta Corporation (“Nitta”).

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Landec was incorporated in California on October 31, 1986. We completed our initial public offering in 1996 and our Common Stock is listed on The NASDAQ Global Select Market under the symbol "LNDC." Our principal executive offices are located at 3603 Haven Avenue, Menlo Park, California 94025 and our telephone number is (650) 306-1650.

### **Description of Core Business**

Landec participates in three core business segments— Food Products Technology, Commodity Trading and Technology Licensing.

#### ***Food Products Technology Business***

The Company began marketing its proprietary Intelimer-based BreatheWay membranes in 1996 for use in the fresh-cut produce packaging market, one of the fastest growing segments in the produce industry. Landec's proprietary BreatheWay packaging technology when combined with fresh-cut or whole produce results in packaged produce with increased shelf life and reduced shrink (waste) without the need for ice during the distribution cycle. The resulting products are referred to as "value-added" products. In 1999, the Company acquired Apio, its then largest customer in the Food Products Technology business and one of the nation's leading marketers and packers of produce and specialty packaged fresh-cut vegetables. Apio utilizes state-of-the-art fresh-cut produce processing technology and year-round access to specialty packaged produce products which Apio distributes to the top U.S. retail grocery chains, major club stores and to the foodservice industry. The Company's proprietary BreatheWay packaging business has been combined with Apio into a subsidiary that retains the Apio, Inc. name. This vertical integration within the Food Products Technology business gives Landec direct access to the large and growing fresh-cut and whole produce market. During the fiscal year ended May 25, 2008, Apio shipped more than nineteen million cartons of produce to leading supermarket retailers, wholesalers, foodservice suppliers and club stores throughout the United States and internationally, primarily in Asia.

There are four major distinguishing characteristics of Apio that provide competitive advantages in the Food Products Technology market:

- **Value-Added Supplier:** Apio has structured its business as a marketer and seller of fresh-cut and whole value-added produce. It is focused on selling products under its Eat Smart® brand and other brands for its fresh-cut and whole value-added products. As retail grocery and club store chains consolidate, Apio is well positioned as a single source of a broad range of products.
- **Reduced Farming Risks:** Apio reduces its farming risk by not taking ownership of farmland, and instead, contracts with growers for produce. The year-round sourcing of produce is a key component to the fresh-cut and whole value-added processing business.
- **Lower Cost Structure:** Apio has strategically invested in the rapidly growing fresh-cut and whole value-added business. Apio's 96,000 square foot value-added processing plant is automated with state-of-the-art vegetable processing equipment. Virtually all of Apio's value-added products utilize Apio's proprietary BreatheWay packaging technology. Apio's strategy is to operate one large central processing facility in one of California's largest, lowest cost growing regions (Santa Maria Valley) and use packaging technology to allow for the nationwide delivery of fresh produce products.

**Expanded Product Line Using Technology:** Apio, through the use of its BreatheWay packaging technology, is introducing on average fifteen new value-added products each year. These new product offerings range from various sizes of fresh-cut bagged products, to vegetable trays, to whole produce, to vegetable salads and snack packs. During the last twelve months, Apio has introduced 18 new products.

Apio established its Apio Packaging division of the Food Products Technology business in 2005 to advance the sales of BreatheWay packaging technology for shelf-life sensitive vegetables and fruit. The technology also includes unique packaging solutions for produce in large packages including shipping and pallet-sized containers.

Apio Packaging's first program has concentrated on bananas and was formally consummated when Apio entered into an agreement to supply Chiquita Brands International, Inc. ("Chiquita") with its proprietary banana packaging technology on a worldwide basis for the ripening, conservation and shelf-life extension of bananas for most applications on an exclusive basis and for other applications on a non-exclusive basis. In addition, Apio provides Chiquita with ongoing research and development and process technology support for the BreatheWay membranes and bags, and technical service support throughout the customer chain in order to assist in the development and market acceptance of the technology.

For its part, Chiquita provides marketing, distribution and retail sales support for Chiquita® bananas sold worldwide in BreatheWay packaging. To maintain the exclusive license, Chiquita must meet quarterly minimum purchase thresholds of BreatheWay banana packages.

The initial market focus for the BreatheWay banana packaging technology using Chiquita bananas has been commercial outlets that normally do not sell bananas because of their short shelf-life – outlets such as quick serve restaurants, convenience stores and coffee chain outlets. Chiquita is currently developing packaging designs for bananas packaged with Landec's BreatheWay technology for sale in quick serve restaurants and retail grocery chains.

During fiscal year 2008, the Company expanded the use of its BreatheWay technology to avocados under an expanded licensing agreement with Chiquita. Commercial sales of avocados into the food service industry recently began and retail grocery store trials are expected to begin during the fall of 2008.

In May 2007, Apio entered into an 18-month research and development agreement with Natick Soldier Research, Development & Engineering Center, a branch of the U.S. Military, to develop commercial uses for Landec's BreatheWay packaging technology within the U.S. Military by significantly increasing the shelf life of produce for overseas shipments.

In June 2008, Apio entered into a collaboration agreement with Seminis Vegetable Seeds, Inc., a wholly-owned subsidiary of Monsanto, to develop novel broccoli and cauliflower products for the exclusive sale by Apio in the North American market. These novel products will be packaged in Landec's proprietary BreatheWay packaging and will be sold to retail grocery chains, club stores and the food service industry. Field trials for the initial target varieties are expected to begin in the fall of 2008.

In addition, the Company has commercialized new lines of fresh cut vegetable side dishes, vegetable salads and vegetable snacks.

### ***Commodity Trading Business***

Commodity Trading revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia through Apio's export company, Cal-Ex and from the purchase and sale of whole commodity fruit and vegetable products domestically to Wal-Mart. The Commodity Trading business is

a buy/sell business that realizes a commission-based margin on average in the 5-6% range.

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## ***Technology Licensing Businesses***

### ***The Technology and Market Opportunity: Intellicoat Seed Coatings***

Following the sale of FCD, our strategy has been to work closely with Monsanto to further develop our patented, functional polymer coating technology that can be broadly sold and/or licensed to the seed industry. In accordance with our license, supply and R&D agreement with Monsanto, we are currently focused on commercializing products for the seed corn market and then plan to broaden the technology to other seed crop applications.

Landec's Intellicoat seed coating applications are designed to control seed germination timing, increase crop yields, reduce risks and extend crop-planting windows. These coatings are currently available on hybrid corn, soybeans and male inbred corn used for seed production. In fiscal year 2000, Landec Ag launched its first commercial product, Pollinator Plus<sup>®</sup> coatings, which is a coating application used by seed companies as a method for spreading pollination to increase yields and reduce risk in the production of hybrid seed corn. There are approximately 650,000 acres of seed production in the United States and in 2008 Pollinator Plus was used by 25 seed companies on approximately 17% of the seed corn production acres in the U.S.

In 2003, Landec commercialized Early Plant<sup>®</sup> corn by selling the product directly to farmers through the Fielder's Choice Direct<sup>®</sup> brand. This application allows farmers to plant into cold soils without the risk of chilling injury, and enables farmers to plant as much as four weeks earlier than normal. With this capability, farmers are able to utilize labor and equipment more efficiently, provide flexibility during the critical planting period and avoid yield losses caused by late planting. In 2008, five seed companies offered Intellicoat on their hybrid seed corn offerings.

Monsanto announced several months ago that it has formed a new business called the Seed Treatment Business which will allow Monsanto to develop its seed treatment requirements internally. The concept of seed treatments is to place an insecticide or fungicide directly onto the seed surface in order to protect the seed and the seedling as it emerges. Landec's Intellicoat seed coating technology could be an integral and proprietary part of Monsanto's commitment to building a major position in seed treatments worldwide by using Landec's seed coatings as a "carrier" of insecticides/fungicides which can be dispensed at the appropriate time based on time or soil temperature.

### ***The Technology and Market Opportunity: Intelimer Polymer Applications***

We believe our technology has commercial potential in a wide range of industrial, consumer and medical applications beyond those identified in our core businesses. For example, our core patented technology, Intelimer materials, can be used to trigger catalysts, insecticides or fragrances just by changing the temperature of the Intelimer materials or to activate adhesives through controlled temperature change. In order to exploit these opportunities, we have entered into and will enter into licensing and collaborative corporate agreements for product development and/or distribution in certain fields. However, given the infrequency and unpredictability of when the Company may enter into any such licensing and research and development arrangements, the Company is unable to disclose its financial expectations in advance of entering into such arrangements.

### ***Industrial Materials and Adhesives***

Landec's industrial product development strategy is to focus on coatings, catalysts, resins, additives and adhesives in the polymer materials market. During the product development stage, the Company identifies corporate partners to support the ongoing development and testing of these products, with the ultimate goal of licensing the applications at the appropriate time.

### ***Intelimer Polymer Systems***



Landec has developed latent catalysts useful in extending pot-life, extending shelf life, reducing waste and improving thermoset cure methods. Some of these latent catalysts are currently being distributed by Akzo-Nobel Chemicals B.V. through a licensing agreement with Air Products. The Company has also developed Intelimer polymer materials useful in enhancing the formulating options for various personal care products. The rights to develop and sell Landec's latent catalysts and personal care technologies were licensed to Air Products in March 2006.

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*Personal Care and Cosmetic Applications*

Landec's personal care and cosmetic applications strategy is focused on supplying Intelimer materials to industry leaders for use in lotions and creams, and potentially color cosmetics, lipsticks and hair care. The Company's partner, Air Products, is currently shipping products to L'Oreal for use in lotions and creams. To date, the sales of Landec materials used in L'Oreal products have not been significant to the Company's financials.

*Medical Applications*

On December 23, 2005, Landec entered into an exclusive licensing agreement with Aesthetic Sciences Corporation ("Aesthetic Sciences"). Aesthetic Sciences paid Landec an upfront license fee of \$250,000 for the exclusive rights to use Landec's Intelimer materials technology for the development of dermal fillers worldwide. Landec will also receive royalties on the sale of products incorporating Landec's technology. In addition, the Company has received shares of preferred stock valued at \$1.8 million which as of August 31, 2008 represented a 16.4% ownership interest in Aesthetic Sciences. At this time, the Company is unable to predict the ultimate outcome of the collaboration with Aesthetic Sciences and the timing or amount of future revenues, if any.

**Results of Operations**

**Revenues** (in thousands):

|                                   | <b>Three months<br/>ended 8/31/08</b> | <b>Three months<br/>ended 8/26/07</b> | <b>Change</b> |
|-----------------------------------|---------------------------------------|---------------------------------------|---------------|
| <i><b>Apio Value Added</b></i>    | \$ 43,002                             | \$ 39,394                             | 9%            |
| <i><b>Apio Packaging</b></i>      | 812                                   | 153                                   | 431%          |
| <i><b>Apio Tech. Subtotal</b></i> | 43,814                                | 39,547                                | 11%           |
| <i><b>Commodity Trading</b></i>   | 26,297                                | 21,451                                | 23%           |
| <i><b>Total Apio</b></i>          | 70,111                                | 60,998                                | 15%           |
| <i><b>Tech. Licensing</b></i>     | 1,642                                 | 1,661                                 | (1)%          |
| <i><b>Total Revenues</b></i>      | \$ 71,753                             | \$ 62,659                             | 15%           |

*Apio Value Added*

Apio's value-added revenues consist of revenues generated from the sale of specialty packaged fresh-cut and whole value-added processed vegetable products that are washed and packaged in our proprietary packaging and sold under Apio's Eat Smart brand and various private labels. In addition, value-added revenues include the revenues generated from Apio Cooling, LP, a vegetable cooling operation in which Apio is the general partner with a 60% ownership position.

The increase in Apio's value-added revenues for the three months ended August 31, 2008 compared to the same period last year is due to increased product offerings, increased sales to existing customers and the addition of new customers. Overall value-added sales volume increased 8% during the first quarter of fiscal year 2009 compared to the same period last year.

*Apio Packaging*

Apio packaging revenues consist of Apio's packaging technology business using its BreatheWay membrane technology. The first commercial application included in Apio packaging is our banana packaging technology.

The increase in Apio packaging revenues for the three months ended August 31, 2008 compared to the same period last year was primarily due to the timing of contractual minimum payments from Chiquita as a result of the amended Chiquita license agreement.

*Commodity Trading*

Apio trading revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia by Cal-Ex and from the purchase and sale of whole commodity fruit and vegetable products domestically to Wal-Mart. The export portion of trading revenues for the first quarter of fiscal year 2008 was \$21.7 million or 82% of total trading revenues.

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The increase in revenues in Apio's trading business for the three months ended August 31, 2008 compared to the same period last year was due to a 8% increase in export sales volumes as a result of an increased supply of produce to export and a 84% increase in domestic commodity sales volumes to Wal-Mart due to the timing of the harvest for certain produce, primarily cherries, which was earlier than the harvest last year.

#### *Technology Licensing*

Technology licensing revenues consist of revenues generated from the licensing agreements with Monsanto, Air Products and Nitta.

The decrease in Technology Licensing revenues for the three months ended August 31, 2008 compared to the same period of the prior year was not significant to consolidated Landec revenues.

#### **Gross Profit** (in thousands):

|                            | <i>Three months<br/>ended 8/31/08</i> | <i>Three months<br/>ended 8/26/07</i> | <i>Change</i> |
|----------------------------|---------------------------------------|---------------------------------------|---------------|
| <i>Apio Value Added</i>    | \$ 6,580                              | \$ 6,103                              | 8%            |
| <i>Apio Packaging</i>      | 703                                   | 119                                   | 491%          |
| <i>Apio Tech. Subtotal</i> | 7,283                                 | 6,222                                 | 17%           |
| <i>Commodity Trading</i>   | 1,198                                 | 1,091                                 | 10%           |
| <i>Total Apio</i>          | 8,481                                 | 7,313                                 | 16%           |
| <i>Tech. Licensing</i>     | 1,642                                 | 1,661                                 | (1)%          |
| <i>Total Gross Profit</i>  | \$ 10,123                             | \$ 8,974                              | 13%           |

#### *General*

There are numerous factors that can influence gross profit including product mix, customer mix, manufacturing costs, volume, sale discounts and charges for excess or obsolete inventory, to name a few. Many of these factors influence or are interrelated with other factors. Therefore, it is difficult to precisely quantify the impact of each item individually. The Company includes in cost of sales all the costs related to the sale of products in accordance with generally accepted accounting principles. These costs include the following: raw materials (including produce and packaging), direct labor, overhead (including indirect labor, depreciation, and facility related costs) and shipping and shipping related costs. The following discussion surrounding gross profit includes management's best estimates of the reasons for the changes for the first quarter of fiscal year 2009 compared to the same period last year as outlined in the table above.

#### *Apio Value-Added*

The increase in gross profit for Apio's value-added specialty packaged vegetable business for the three months ended August 31, 2008 compared to the same period last year was primarily due to the increase in revenues of 9% during the first quarter of fiscal year 2009 compared to the first quarter of last year.

#### *Apio Packaging*

The increase in gross profit for Apio Packaging for the three months ended August 31, 2008 compared to the same period last year was primarily due to the timing of contractual minimum payments from Chiquita as a result of the amended Chiquita license agreement.

#### *Commodity Trading*

Apio's commodity trading business is a buy/sell business that realizes a commission-based margin in the 5-6% range. The increase in gross profit for Apio's commodity trading business during the three months ended August 31, 2008 compared to the same period last year was primarily due to a 23% increase in revenues. The increase in revenues was greater than the increase in gross profit because the increase in revenues was primarily due to increased domestic commodity volume sales which is a 2% margin business.

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*Technology Licensing*

The decrease in Technology Licensing gross profit for the three months ended August 31, 2008 compared to the same period of the prior year was not significant to consolidated Landec gross profit.

**Operating Expenses** (in thousands):

|  | <i>Three months<br/>ended 8/31/08</i> | <i>Three months<br/>ended 8/26/07</i> | <i>Change</i> |
|--|---------------------------------------|---------------------------------------|---------------|
| <b><i>Research and Development:</i></b>            |                                       |                                       |               |
| <i>Apio</i>  | \$ 351                                | \$ 370                                | (5)%          |
| <i>Tech. Licensing</i>                             | 537                                   | 452                                   | 19%           |
| <b><i>Total R&amp;D</i></b>                        | <b>\$ 888</b>                         | <b>\$ 822</b>                         | <b>8%</b>     |
| <b><i>Selling, General and Administrative:</i></b> |                                       |                                       |               |
| <i>Apio</i>  | \$ 3,500                              | \$ 3,361                              | 4%            |
| <i>Corporate</i>                                   | 1,176                                 | 1,185                                 | (1)%          |
| <b><i>Total S,G&amp;A</i></b>                      | <b>\$ 4,676</b>                       | <b>\$ 4,546</b>                       | <b>3%</b>     |

*Research and Development*

Landec's research and development expenses consist primarily of expenses involved in the development and process scale-up initiatives. Research and development efforts at Apio are focused on the Company's proprietary BreatheWay membranes used for packaging produce, with recent focus on extending the shelf life of bananas and other shelf-life sensitive vegetables and fruit. In the Technology Licensing business, the research and development efforts are focused on the Company's proprietary Intellicoat coatings for seeds, primarily corn seed and on uses for our proprietary Intelimer polymers outside of food and agriculture.

The increase in research and development expenses for the three months ended August 31, 2008 compared to the same period last year was not significant.

*Selling, General and Administrative*

Selling, general and administrative expenses consist primarily of sales and marketing expenses associated with Landec's product sales and services, business development expenses and staff and administrative expenses.

The increase in selling, general and administrative expenses for the three months ended August 31, 2008 compared to the same period last year was not significant.

**Other** (in thousands):

|                                      | <i>Three months<br/>ended 8/31/08</i> | <i>Three months<br/>ended 8/26/07</i> | <i>Change</i> |
|--------------------------------------|---------------------------------------|---------------------------------------|---------------|
| <b><i>Interest Income</i></b>        | <b>\$ 357</b>                         | <b>\$ 781</b>                         | <b>(54)%</b>  |
| <b><i>Interest Expense</i></b>       | <b>(2)</b>                            | <b>(8)</b>                            | <b>(75)%</b>  |
| <b><i>Minority Interest Exp.</i></b> | <b>(164)</b>                          | <b>(120)</b>                          | <b>37%</b>    |
| <b><i>Total Other</i></b>            | <b>\$ 191</b>                         | <b>\$ 653</b>                         | <b>(71)%</b>  |
| <b><i>Income Taxes</i></b>           | <b>\$ 1,911</b>                       | <b>\$ 1,182</b>                       | <b>62%</b>    |



*Interest Income*

The decrease in interest income for the three months ended August 31, 2008 compared to the same period last year was primarily due to lower yields on investments, driven by both declines in interest rates and a shift in our investment portfolio to more conservative investments.

*Interest Expense*

The decrease in interest expense during the three months ended August 31, 2008 compared to the same period last year was not significant.

*Minority Interest Expense*

The minority interest expense consists of the minority interest associated with the limited partners' equity interest in the net income of Apio Cooling, LP.

The increase in the minority interest for the three months ended August 31, 2008 compared to the first quarter of last year was not significant.

*Income Taxes*

The increase in the income tax expense is due to the Company utilizing all of its net operating loss carryforwards and tax credits during fiscal year 2008 for book income tax expense purposes which resulted in the estimated effective tax rate for fiscal year 2009 increasing to 40% for federal and state income taxes.

**Liquidity and Capital Resources**

As of August 31, 2008, the Company had cash and cash equivalents of \$45.7 million, a net increase of \$1.3 million from \$44.4 million at May 25, 2008.

*Cash Flow from Operating Activities*

Landec generated \$2.2 million of cash flow from operating activities during the three months ended August 31, 2008 compared to generating \$2.8 million in operating activities for the three months ended August 26, 2007. The primary source of cash from operating activities was from generating \$2.8 million of net income partially offset by non-cash related expenses of \$631,000.

*Cash Flow from Investing Activities*

Net cash used in investing activities for the three months ended August 31, 2008 was \$2.5 million compared to \$240,000 for the same period last year. The primary uses of cash from investing activities during the first quarter of fiscal year 2009 were for the purchase of \$874,000 of property and equipment primarily for the further automation of Apio's value-added facility and from the net purchase of \$1.6 million of marketable securities.

*Cash Flow from Financing Activities*

Net cash provided by financing activities for the three months ended August 31, 2008 was \$1.7 million compared to the use of \$18.9 million for the same period last year. The source of cash from financing activities during the first quarter of fiscal year 2009 was from the tax benefit from stock-based compensation of \$1.7 million.





### *Capital Expenditures*

During the three months ended August 31, 2008, Landec purchased vegetable processing equipment to support the further automation of Apio's value added processing facility. These expenditures represented the majority of the \$874,000 of capital expenditures.

### *Debt*

Apio has a \$7.0 million revolving line of credit with Wells Fargo Bank N.A. Outstanding amounts under the line of credit bear interest at either the prime rate less 0.50% or the LIBOR adjustable rate plus 1.50%. The revolving line of credit with Wells Fargo (collectively, the "Loan Agreement") contains certain restrictive covenants, which require Apio to meet certain financial tests, including minimum levels of net income, maximum leverage ratio, minimum net worth and maximum capital expenditures. Landec has pledged substantially all of the assets of Apio to secure the lines with Wells Fargo. At August 31, 2008, no amounts were outstanding under the revolving line of credit. Apio has been in compliance with all loan covenants during the three months ended August 31, 2008.

Landec is not a party to any agreements with, or commitments to, any special purpose entities that would constitute material off-balance sheet financing other than the operating lease commitments listed above.

Landec's future capital requirements will depend on numerous factors, including the progress of its research and development programs; the continued development of marketing, sales and distribution capabilities; the ability of Landec to establish and maintain new collaborative and licensing arrangements; any decision to pursue additional acquisition opportunities; weather conditions that can affect the supply and price of produce, the timing and amount, if any, of payments received under licensing and research and development agreements; the costs involved in preparing, filing, prosecuting, defending and enforcing intellectual property rights; the ability to comply with regulatory requirements; the emergence of competitive technology and market forces; the effectiveness of product commercialization activities and arrangements; and other factors. If Landec's currently available funds, together with the internally generated cash flow from operations are not sufficient to satisfy its capital needs, Landec would be required to seek additional funding through other arrangements with collaborative partners, additional bank borrowings and public or private sales of its securities. There can be no assurance that additional funds, if required, will be available to Landec on favorable terms if at all.

Landec believes that its debt facilities, cash from operations, along with existing cash, cash equivalents and existing borrowing capacities will be sufficient to finance its operational and capital requirements for at least the next twelve months.

### **Additional Factors That May Affect Future Results**

Landec desires to take advantage of the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995 and of Section 21E and Rule 3b-6 under the Securities Exchange Act of 1934. Specifically, Landec wishes to alert readers that the following important factors, as well as other factors including, without limitation, those described elsewhere in this report, could in the future affect, and in the past have affected, Landec's actual results and could cause Landec's results for future periods to differ materially from those expressed in any forward-looking statements made by or on behalf of Landec. Landec assumes no obligation to update such forward-looking statements.

### ***Our Future Operating Results Are Likely to Fluctuate Which May Cause Our Stock Price to Decline***

In the past, our results of operations have fluctuated significantly from quarter to quarter and are expected to continue to fluctuate in the future. Historically, Landec Ag has been the primary source of these fluctuations, as its revenues and profits were concentrated over a few months during the spring planting season (generally during our third and

fourth fiscal quarters). In addition, Apio can be heavily affected by seasonal and weather factors which have impacted quarterly results, such as the high cost of sourcing product in June/July 2006 and January 2007 due to a shortage of essential value-added produce items. Our earnings may also fluctuate based on our ability to collect accounts receivables from customers and note receivables from growers and on price fluctuations in the fresh vegetables and fruits markets. Other factors that affect our food and/or agricultural operations include:

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- the seasonality of our supplies;
- our ability to process produce during critical harvest periods;
- the timing and effects of ripening;
- the degree of perishability;
- the effectiveness of worldwide distribution systems;
- total worldwide industry volumes;
- the seasonality of consumer demand;
- foreign currency fluctuations; and
- foreign importation restrictions and foreign political risks.

As a result of these and other factors, we expect to continue to experience fluctuations in quarterly operating results.

***We May Not Be Able to Achieve Acceptance of Our New Products in the Marketplace***

Our success in generating significant sales of our products will depend in part on the ability of us and our partners and licensees to achieve market acceptance of our new products and technology. The extent to which, and rate at which, we achieve market acceptance and penetration of our current and future products is a function of many variables including, but not limited to:

- price;
- safety;
- efficacy;
- reliability;
- conversion costs;
- marketing and sales efforts; and
- general economic conditions affecting purchasing patterns.

We may not be able to develop and introduce new products and technologies in a timely manner or new products and technologies may not gain market acceptance. We are in the early stage of product commercialization of certain Intelimer-based specialty packaging, Intellicoat seed coatings and other Intelimer polymer products and many of our potential products are in development. We believe that our future growth will depend in large part on our ability to develop and market new products in our target markets and in new markets. In particular, we expect that our ability to compete effectively with existing food products, agricultural, industrial and medical companies will depend substantially on successfully developing, commercializing, achieving market acceptance of and reducing the cost of producing our products. In addition, commercial applications of our temperature switch polymer technology are relatively new and evolving. Our failure to develop new products or the failure of our new products to achieve market

acceptance would have a material adverse effect on our business, results of operations and financial condition.

***We Face Strong Competition in the Marketplace***

Competitors may succeed in developing alternative technologies and products that are more effective, easier to use or less expensive than those which have been or are being developed by us or that would render our technology and products obsolete and non-competitive. We operate in highly competitive and rapidly evolving fields, and new developments are expected to continue at a rapid pace. Competition from large food products, agricultural, industrial and medical companies is expected to be intense. In addition, the nature of our collaborative arrangements may result in our corporate partners and licensees becoming our competitors. Many of these competitors have substantially greater financial and technical resources and production and marketing capabilities than we do, and may have substantially greater experience in conducting clinical and field trials, obtaining regulatory approvals and manufacturing and marketing commercial products.

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***We Have a Concentration of Manufacturing in One Location for Apio and May Have to Depend on Third Parties to Manufacture Our Products***

Any disruptions in our primary manufacturing operation at Apio's facility in Guadalupe, California would reduce our ability to sell our products and would have a material adverse effect on our financial results. Additionally, we may need to consider seeking collaborative arrangements with other companies to manufacture our products. If we become dependent upon third parties for the manufacture of our products, our profit margins and our ability to develop and deliver those products on a timely basis may be affected. Failures by third parties may impair our ability to deliver products on a timely basis and impair our competitive position. We may not be able to continue to successfully operate our manufacturing operations at acceptable costs, with acceptable yields, and retain adequately trained personnel.

***Our Dependence on Single-Source Suppliers and Service Providers May Cause Disruption in Our Operations Should Any Supplier Fail to Deliver Materials***

We may experience difficulty acquiring materials or services for the manufacture of our products or we may not be able to obtain substitute vendors. We may not be able to procure comparable materials at similar prices and terms within a reasonable time. Several services that are provided to Apio are obtained from a single provider. Several of the raw materials we use to manufacture our products are currently purchased from a single source, including some monomers used to synthesize Intelimer polymers and substrate materials for our breathable membrane products. Any interruption of our relationship with single-source suppliers or service providers could delay product shipments and materially harm our business.

***We May Be Unable to Adequately Protect Our Intellectual Property Rights***

We may receive notices from third parties, including some of our competitors, claiming infringement by our products of patent and other proprietary rights. Regardless of their merit, responding to any such claim could be time-consuming, result in costly litigation and require us to enter royalty and licensing agreements which may not be offered or available on terms acceptable to us. If a successful claim is made against us and we fail to develop or license a substitute technology, we could be required to alter our products or processes and our business, results of operations or financial position could be materially adversely affected. Our success depends in large part on our ability to obtain patents, maintain trade secret protection and operate without infringing on the proprietary rights of third parties. Any pending patent applications we file may not be approved and we may not be able to develop additional proprietary products that are patentable. Any patents issued to us may not provide us with competitive advantages or may be challenged by third parties. Patents held by others may prevent the commercialization of products incorporating our technology. Furthermore, others may independently develop similar products, duplicate our products or design around our patents.

***Our Operations Are Subject to Regulations that Directly Impact Our Business***

Our food packaging products are subject to regulation under the Food, Drug and Cosmetic Act (the "FDC Act"). Under the FDC Act, any substance that when used as intended may reasonably be expected to become, directly or indirectly, a component or otherwise affect the characteristics of any food may be regulated as a food additive unless the substance is generally recognized as safe. We believe that food packaging materials are generally not considered food additives by the FDA because these products are not expected to become components of food under their expected conditions of use. We consider our breathable membrane product to be a food packaging material not subject to regulation or approval by the FDA. We have not received any communication from the FDA concerning our breathable membrane product. If the FDA were to determine that our breathable membrane products are food additives, we may be required to submit a food additive petition for approval by the FDA. The food additive petition process is lengthy, expensive and uncertain. A determination by the FDA that a food additive petition is necessary

would have a material adverse effect on our business, operating results and financial condition.

Federal, state and local regulations impose various environmental controls on the use, storage, discharge or disposal of toxic, volatile or otherwise hazardous chemicals and gases used in some of the manufacturing processes. Our failure to control the use of, or to restrict adequately the discharge of, hazardous substances under present or future regulations could subject us to substantial liability or could cause our manufacturing operations to be suspended and changes in environmental regulations may impose the need for additional capital equipment or other requirements.

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Our agricultural operations are subject to a variety of environmental laws including, the Food Quality Protection Act of 1966, the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act, the Federal Insecticide, Fungicide and Rodenticide Act, and the Comprehensive Environmental Response, Compensation and Liability Act. Compliance with these laws and related regulations is an ongoing process. Environmental concerns are, however, inherent in most agricultural operations, including those we conduct. Moreover, it is possible that future developments, such as increasingly strict environmental laws and enforcement policies could result in increased compliance costs.

The Company is subject to the Perishable Agricultural Commodities Act (“PACA”) law. PACA regulates fair trade standards in the fresh produce industry and governs all the products sold by Apio. Our failure to comply with the PACA requirements could among other things, result in civil penalties, suspension or revocation of a license to sell produce, and in the most egregious cases, criminal prosecution, which could have a material adverse effect on our business.

***Adverse Weather Conditions and Other Acts of God May Cause Substantial Decreases in Our Sales and/or Increases in Our Costs***

Our Food Products business is subject to weather conditions that affect commodity prices, crop yields, and decisions by growers regarding crops to be planted. Crop diseases and severe conditions, particularly weather conditions such as floods, droughts, frosts, windstorms, earthquakes and hurricanes, may adversely affect the supply of vegetables and fruits used in our business, which could reduce the sales volumes and/or increase the unit production costs. Because a significant portion of the costs are fixed and contracted in advance of each operating year, volume declines due to production interruptions or other factors could result in increases in unit production costs which could result in substantial losses and weaken our financial condition.

***We Depend on Strategic Partners and Licenses for Future Development***

Our strategy for development, clinical and field testing, manufacture, commercialization and marketing for some of our current and future products includes entering into various collaborations with corporate partners, licensees and others. We are dependent on our corporate partners to develop, test, manufacture and/or market some of our products. Although we believe that our partners in these collaborations have an economic motivation to succeed in performing their contractual responsibilities, the amount and timing of resources to be devoted to these activities are not within our control. Our partners may not perform their obligations as expected or we may not derive any additional revenue from the arrangements. Our partners may not pay any additional option or license fees to us or may not develop, market or pay any royalty fees related to products under the agreements. Moreover, some of the collaborative agreements provide that they may be terminated at the discretion of the corporate partner, and some of the collaborative agreements provide for termination under other circumstances. Our partners may pursue existing or alternative technologies in preference to our technology. Furthermore, we may not be able to negotiate additional collaborative arrangements in the future on acceptable terms, if at all, and our collaborative arrangements may not be successful.

***Both Domestic and Foreign Government Regulations Can Have an Adverse Effect on Our Business Operations***

Our products and operations are subject to governmental regulation in the United States and foreign countries. The manufacture of our products is subject to periodic inspection by regulatory authorities. We may not be able to obtain necessary regulatory approvals on a timely basis or at all. Delays in receipt of or failure to receive approvals or loss of previously received approvals would have a material adverse effect on our business, financial condition and results of operations. Although we have no reason to believe that we will not be able to comply with all applicable regulations regarding the manufacture and sale of our products and polymer materials, regulations are always subject to change and depend heavily on administrative interpretations and the country in which the products are sold. Future changes in



regulations or interpretations relating to matters such as safe working conditions, laboratory and manufacturing practices, environmental controls, and disposal of hazardous or potentially hazardous substances may adversely affect our business.

We are subject to USDA rules and regulations concerning the safety of the food products handled and sold by Apio, and the facilities in which they are packed and processed. Failure to comply with the applicable regulatory requirements can, among other things, result in:

· fines, injunctions, civil penalties, and suspensions,

· withdrawal of regulatory approvals,

product recalls and product seizures, including cessation of manufacturing and sales,  
operating restrictions, and  
criminal prosecution.

We may be required to incur significant costs to comply with the laws and regulations in the future which may have a material adverse effect on our business, operating results and financial condition.

***Our International Operations and Sales May Expose Our Business to Additional Risks***

For the three months ended August 31, 2008, approximately 36% of our total revenues were derived from product sales to international customers. A number of risks are inherent in international transactions. International sales and operations may be limited or disrupted by any of the following:

regulatory approval process,  
government controls,  
export license requirements,  
political instability,  
price controls,  
trade restrictions,  
changes in tariffs, or  
difficulties in staffing and managing international operations.

Foreign regulatory agencies have or may establish product standards different from those in the United States, and any inability to obtain foreign regulatory approvals on a timely basis could have a material adverse effect on our international business, and our financial condition and results of operations. While our foreign sales are currently priced in dollars, fluctuations in currency exchange rates may reduce the demand for our products by increasing the price of our products in the currency of the countries to which the products are sold. Regulatory, geopolitical and other factors may adversely impact our operations in the future or require us to modify our current business practices.

***Cancellations or Delays of Orders by Our Customers May Adversely Affect Our Business***

During three months ended August 31, 2008, sales to our top five customers accounted for approximately 49% of our revenues, with our largest customer, Costco Wholesale Corporation, accounting for approximately 19% of our revenues. We expect that, for the foreseeable future, a limited number of customers may continue to account for a substantial portion of our net revenues. We may experience changes in the composition of our customer base as we have experienced in the past. We do not have long-term purchase agreements with any of our customers. The reduction, delay or cancellation of orders from one or more major customers for any reason or the loss of one or more of our major customers could materially and adversely affect our business, operating results and financial condition. In addition, since some of the products processed by Apio at its Guadalupe, California facility are sole sourced to its customers, our operating results could be adversely affected if one or more of our major customers were to develop other sources of supply. Our current customers may not continue to place orders, orders by existing customers may be

canceled or may not continue at the levels of previous periods or we may not be able to obtain orders from new customers.

***Our Sale of Some Products May Increase Our Exposure to Product Liability Claims***

The testing, manufacturing, marketing, and sale of the products we develop involve an inherent risk of allegations of product liability. If any of our products were determined or alleged to be contaminated or defective or to have caused a harmful accident to an end-customer, we could incur substantial costs in responding to complaints or litigation regarding our products and our product brand image could be materially damaged. Either event may have a material adverse effect on our business, operating results and financial condition. Although we have taken and intend to continue to take what we believe are appropriate precautions to minimize exposure to product liability claims, we may not be able to avoid significant liability. We currently maintain product liability insurance. While we believe the coverage and limits are consistent with industry standards, our coverage may not be adequate or may not continue to be available at an acceptable cost, if at all. A product liability claim, product recall or other claim with respect to uninsured liabilities or in excess of insured liabilities could have a material adverse effect on our business, operating results and financial condition.

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***Our Stock Price May Fluctuate in Accordance with Market Conditions***

The following events may cause the market price of our common stock to fluctuate significantly:

- technological innovations applicable to our products,
- our attainment of (or failure to attain) milestones in the commercialization of our technology,
- our development of new products or the development of new products by our competitors,
- new patents or changes in existing patents applicable to our products,
- our acquisition of new businesses or the sale or disposal of a part of our businesses,
- development of new collaborative arrangements by us, our competitors or other parties,
- changes in government regulations applicable to our business,
- changes in investor perception of our business,
- fluctuations in our operating results and
- changes in the general market conditions in our industry.

These broad fluctuations may adversely affect the market price of our common stock.

***Our Controlling Shareholders Exert Significant Influence over Corporate Events that May Conflict with the Interests of Other Shareholder***

Our executive officers and directors and their affiliates own or control approximately 12% of our common stock (including options exercisable within 60 days). Accordingly, these officers, directors and shareholders may have the ability to exert significant influence over the election of our Board of Directors, the approval of amendments to our articles and bylaws and the approval of mergers or other business combination transactions requiring shareholder approval. This concentration of ownership may have the effect of delaying or preventing a merger or other business combination transaction, even if the transaction or amendments would be beneficial to our other shareholders. In addition, our controlling shareholders may approve amendments to our articles or bylaws to implement anti-takeover or management friendly provisions that may not be beneficial to our other shareholders.

***We May Be Exposed to Employment Related Claims and Costs that Could Materially Adversely Affect Our Business***

We have been subject in the past, and may be in the future, to claims by employees based on allegations of discrimination, negligence, harassment and inadvertent employment of illegal aliens or unlicensed personnel, and we may be subject to payment of workers' compensation claims and other similar claims. We could incur substantial costs and our management could spend a significant amount of time responding to such complaints or litigation regarding employee claims, which may have a material adverse effect on our business, operating results and financial condition.

***We Are Dependent on Our Key Employees and if One or More of Them Were to Leave, We Could Experience Difficulties in Replacing Them and Our Operating Results Could Suffer***

The success of our business depends to a significant extent upon the continued service and performance of a relatively small number of key senior management, technical, sales, and marketing personnel. The loss of any of our key personnel would likely harm our business. In addition, competition for senior level personnel with knowledge and experience in our different lines of business is intense. If any of our key personnel were to leave, we would need to devote substantial resources and management attention to replace them. As a result, management attention may be diverted from managing our business, and we may need to pay higher compensation to replace these employees.

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***We May Issue Preferred Stock with Preferential Rights that Could Affect Your Rights***

Our Board of Directors has the authority, without further approval of our shareholders, to fix the rights and preferences, and to issue shares, of preferred stock. In November 1999, we issued and sold shares of Series A Convertible Preferred Stock and in October 2001 we issued and sold shares of Series B Convertible Preferred Stock. The Series A Convertible Preferred Stock was converted into 1,666,670 shares of Common Stock in November 2002 and the Series B Convertible Preferred Stock was converted into 1,744,102 shares of Common Stock in May 2004.

The issuance of new shares of preferred stock could have the effect of making it more difficult for a third party to acquire a majority of our outstanding stock, and the holders of such preferred stock could have voting, dividend, liquidation and other rights superior to those of holders of our Common Stock.

***We Have Never Paid any Dividends on Our Common Stock***

We have not paid any cash dividends on our Common Stock since inception and do not expect to do so in the foreseeable future. Any dividends may be subject to preferential dividends payable on any preferred stock we may issue.

***Our Profitability Could Be Materially and Adversely Affected if it Is Determined that the Book Value of Goodwill is Higher than Fair Value***

Our balance sheet includes an amount designated as “goodwill” that represents a portion of our assets and our shareholders’ equity. Goodwill arises when an acquirer pays more for a business than the fair value of the tangible and separately measurable intangible net assets. Under Statement of Financial Accounting Standards No. 142 “*Goodwill and Other Intangible Assets*”, beginning in fiscal year 2002, the amortization of goodwill has been replaced with an “impairment test” which requires that we compare the fair value of goodwill to its book value at least annually and more frequently if circumstances indicate a possible impairment. If we determine at any time in the future that the book value of goodwill is higher than fair value then the difference must be written-off, which could materially and adversely affect our profitability.

***Item 3. Quantitative and Qualitative Disclosures about Market Risk***

None.

***Item 4. Controls and Procedures***

**Evaluation of Disclosure Controls and Procedures**

Our management evaluated, with participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission, and are effective in providing reasonable assurance that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company’s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal controls over financial reporting during the quarter ended August 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

The Company is involved in litigation arising in the normal course of business. The Company is currently not a party to any legal proceedings which management believes could result in the payment of any amounts that would be material to the business or financial condition of the Company.

### Item 1A. Risk Factors

Not applicable.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Submission of Matters to a Vote of Security Holders

None.

### Item 5. Other Information

None.

### Item 6. Exhibits

Exhibit

Number Exhibit Title:

31.1+ CEO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

31.2+ CFO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

32.1+ CEO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2+ CFO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

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+ Filed herewith.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

LANDEC CORPORATION

By:           /s/           Gregory  
                  S. Skinner  
                  Gregory S. Skinner  
                  Vice President, Finance and Chief  
                  Financial Officer  
                  (Principal Financial and  
                  Accounting Officer)

Date: October 6, 2008

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