

LANDEC CORP \CA\
Form 10-Q
October 01, 2010

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 29, 2010, 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)

Delaware
(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 has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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.

Edgar Filing: LANDEC CORP \CA\ - Form 10-Q

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 20, 2010, there were 26,441,778 shares of Common Stock outstanding.

LANDEC CORPORATION

FORM 10-Q For the Fiscal Quarter Ended August 29, 2010

INDEX

	Page
Facing sheet	1
Index	2
Part I. Financial Information	
Item 1. Financial Statements	
a) Consolidated Balance Sheets as of August 29, 2010 and May 30, 2010	3
b) Consolidated Statements of Income for the Three Months Ended August 29, 2010 and August 30, 2009	4
c) Consolidated Statements of Cash Flows for the Three Months Ended August 29, 2010 and August 30, 2009	5
d) Notes to Consolidated Financial Statements	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3. Quantitative and Qualitative Disclosures About Market Risk	27
Item 4. Controls and Procedures	27
Part II. Other Information	28
Item 1. Legal Proceedings	28
Item 1A. Risk Factors	28
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	28
Item 3. Defaults Upon Senior Securities	28
Item 4. Submission of Matters to a Vote of Security Holders	28
Item 5. Other Information	28
Item 6. Exhibits	28

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	August 29, 2010 (Unaudited)	May 30, 2010 (1)
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 9,898	\$ 27,817
Marketable securities	40,736	20,421
Accounts receivable, less allowance for doubtful accounts of \$169 and \$189 at August 29, 2010 and May 30, 2010, respectively	19,619	18,637
Accounts receivable, related party	634	729
Income taxes receivable	669	739
Inventories, net	18,070	16,107
Notes and advances receivable	701	241
Deferred taxes	1,364	1,262
Prepaid expenses and other current assets	2,227	2,989
Total Current Assets	93,918	88,942
Property and equipment, net	50,573	50,161
Goodwill, net	41,189	41,154
Trademarks/tradenames, net	12,428	12,428
Customer relationships, net	3,597	3,674
Other assets	4,024	3,838
Total Assets	\$ 205,729	\$ 200,197
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 17,743	\$ 14,354
Related party accounts payable	511	349
Accrued compensation	2,046	2,043
Other accrued liabilities	2,946	3,277
Deferred revenue	2,704	3,391
Current portion of long-term debt	4,329	4,521
Total Current Liabilities	30,279	27,935
Long-term debt	18,826	19,249
Deferred revenue	500	1,000
Deferred taxes	9,278	8,801
Other non-current liabilities	11,172	10,737
Total Liabilities	70,055	67,722
Stockholders' Equity:		
Common stock, \$0.001 par value; 50,000,000 shares authorized; 26,441,778 and 26,490,259 shares issued and outstanding at August 29, 2010 and May 30, 2010, respectively	27	27
Additional paid-in capital	118,678	117,730

Accumulated other comprehensive loss	(331)	(179)
Retained earnings	15,510	13,206
Total Stockholders' Equity	133,884	130,784
Noncontrolling interest	1,790	1,691
Total Equity	135,674	132,475
Total Liabilities and Stockholders' Equity	\$ 205,729	\$ 200,197

(1) Derived from audited financial statements.

See accompanying notes.

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

	Three Months Ended	
	August 29, 2010	August 30, 2009
Revenues:		
Product sales	\$ 62,261	\$ 58,392
Services revenue, related party	1,065	1,166
License fees	1,350	1,350
Research, development and royalty revenues	277	35
Total revenues	64,953	60,943
Cost of revenue:		
Cost of product sales	50,724	50,106
Cost of product sales, related party	1,562	1,066
Cost of services revenue	850	901
Total cost of revenue	53,136	52,073
Gross profit	11,817	8,870
Operating costs and expenses:		
Research and development	2,232	939
Selling, general and administrative	5,652	4,570
Total operating costs and expenses	7,884	5,509
Operating income	3,933	3,361
Interest income	107	288
Interest expense	(227)	(1)
Other expense	(58)	—
Net income before taxes	3,755	3,648
Income tax expense	(1,352)	(1,282)
Consolidated net income	2,403	2,366
Non controlling interest	(99)	(182)
Net income applicable to Common Stockholders	\$ 2,304	\$ 2,184
Basic net income per share	\$ 0.09	\$ 0.08
Diluted net income per share	\$ 0.09	\$ 0.08
Shares used in per share computation		
Basic	26,500	26,349
Diluted	26,719	26,716

See accompanying notes.

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

	Three months Ended	
	August 29, 2010	August 30, 2009
Cash flows from operating activities:		
Net income applicable to Common Stockholders	\$ 2,304	\$ 2,184
Adjustments. to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,306	762
Stock-based compensation expense	506	220
Tax benefit from stock-based compensation expense	(804)	(622)
Increase in long-term receivable	(200)	(200)
Deferred taxes	375	474
Non controlling interest	99	182
Changes in current assets and current liabilities:		
Accounts receivable, net	(982)	(3,973)
Accounts receivable, related party	95	148
Income taxes receivable	874	—
Inventories, net	(1,963)	(2,610)
Issuance of notes and advances receivable	(774)	(23)
Collection of notes and advances receivable	314	187
Prepaid expenses and other current assets	762	390
Accounts payable	3,389	7,183
Related party accounts payable	162	85
Income taxes payable	—	793
Accrued compensation	3	565
Other accrued liabilities	104	(241)
Deferred revenue	(1,187)	(1,228)
Net cash provided by operating activities	4,383	4,276
Cash flows from investing activities:		
Purchases of property and equipment	(1,676)	(1,344)
Purchase of marketable securities	(34,849)	(54,067)
Proceeds from maturities and sales of marketable securities	14,382	11,105
Net cash used in investing activities	(22,143)	(44,306)
Cash flows from financing activities:		
Repurchase of outstanding common stock	(362)	—
Taxes paid by Company for stock swaps to cover taxes on RSUs	—	(53)
Tax benefit from stock-based compensation expense	804	622
Payments on long-term debt	(615)	—
Decrease in other assets	14	—
Net cash (used in) provided by financing activities	(159)	569
Net decrease in cash and cash equivalents	(17,919)	(39,461)
Cash and cash equivalents at beginning of period	27,817	43,459
Cash and cash equivalents at end of period	\$ 9,898	\$ 3,998

Supplemental schedule of noncash operating activities:

Income tax expense not payable	\$	1,082	\$	622
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 polymer products for food and agricultural products, medical devices and licensed partner applications that incorporate Landec’s patented polymer technologies. The Company has two proprietary polymer technology platforms: 1) Intelimer® polymers, and 2) Hyaluronan (“HA”) biopolymers. The Company’s proprietary polymer technologies are the foundation, and a key differentiating advantage, upon which Landec has built its business. The Company sells 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, Hyaluronan-based biomaterials through its Lifecore Biomedical, Inc. (“Lifecore”) subsidiary and Intellicoat® coated seed products through its Landec Ag LLC (“Landec Ag”) 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 29, 2010 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 30, 2010.

The results of operations for the three months ended August 29, 2010 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, particularly, Apio’s Export business.

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, Lifecore and Landec Ag. All material inter-company transactions and balances have been eliminated.

The Company follows accounting guidance which addresses the consolidation of variable interest entities (“VIEs”). Under the accounting guidance, 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 accounting guidance, 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, 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.

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.

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 (CDs), money market funds and U.S. Treasuries. Short-term marketable securities consist of CDs that are FDIC insured and single A or better rated municipal bonds with original maturities of more than three months at the date of purchase regardless of the maturity date as the Company views its portfolio as available for use in its current operations. The aggregate amount of CDs included in marketable securities at August 29, 2010 and May 30, 2010 was \$753,000 and \$1.5 million, respectively. The Company classifies all debt securities with readily determined market values as "available for sale". The contractual maturities of the Company's marketable securities that are due in less than one year represent \$28.0 million of its marketable securities and those due in one to two years represent the remaining \$12.7 million of the Company's marketable securities as of August 29, 2010. These investments are classified as marketable securities on the consolidated balance sheet as of August 29, 2010 and May 30, 2010 and are carried at fair market value. Unrealized gains and losses are reported as a component of stockholders' equity. 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 29, 2010 and August 30, 2009. During the three months ended August 29, 2010, the Company received proceeds of \$4.9 million from the sale of marketable securities. 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, 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 29, 2010.

Investment in Non-Public Company

The Company's investment in Aesthetic Sciences Corporation ("Aesthetic Sciences"), a medical device company, is carried at cost and adjusted for impairment losses. Since there is no readily available market value information, the Company periodically reviews this investment to determine if any other than temporary declines in value have occurred based on the financial stability and viability of Aesthetic Sciences. Aesthetic Sciences sold the rights to its Smartfil™ Injector System on July 16, 2010. Landec has evaluated its cost method investment for impairment, using a discounted cash flow analysis which included the terms of the purchase agreement. Based on the terms of the agreement, the Company had determined that its investment in Aesthetic Sciences was other than temporarily impaired and therefore recorded an impairment loss of \$1.0 million as of May 30, 2010. The Company's carrying value of its investment in Aesthetic Sciences of \$792,000 at August 29, 2010 is reported as a component of other non current assets.

Fair Value Measurements

The Company adopted fair value measurement accounting guidance on May 26, 2008 for financial assets and liabilities and for 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.

The accounting guidance 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 29, 2010, 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 its cash equivalents and marketable securities as Level 1. As of August 29, 2010, the Company recorded to Other Comprehensive Loss on the Consolidated Balance Sheets an unrealized loss of \$331,000, net of taxes of \$210,000, as a result of an interest rate swap agreement entered into during fiscal year 2010. The unrealized loss was based on a Level 2 hierarchy for fair value measurements. If the interest rate swap is terminated or the debt borrowed is paid off prior to April 30, 2015, the amount of unrealized loss or gain included in Other Comprehensive Income (Loss) would be reclassified to earnings. The Company has no intentions of terminating the interest rate swap or prepaying the debt in the next twelve months. The interest rate swap liability is included in other non-current liabilities as of August 29, 2010 and May 30, 2010. The Company has no other financial assets or liabilities for which fair value measurement has been adopted.

New Accounting Pronouncements

Recently Adopted Pronouncements

Variable Interest Entities

In June 2009, the FASB issued new guidance which amends the evaluation criteria to identify the primary beneficiary of a VIE. Additionally, the new guidance requires ongoing reassessments of whether an enterprise is the primary beneficiary of the VIE. The Company adopted the new guidance on May 31, 2010 and such adoption did not have an impact on the Company's results of operations or financial position for the three months ended August 29, 2010.

Revenue Recognition

In October 2009, the FASB issued new guidance in relation to "Multiple-Deliverable Revenue Arrangements". The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. The Company early adopted these standards as of May 31, 2010. There will be no materially modified agreements as a result of the adoption. The adoption did not have an impact on the Company's results of operations or financial position for the three months ended August 29, 2010.

2. Acquisition of Lifecore Biomedical, Inc.

On April 30, 2010 (the "Acquisition Date"), the Company acquired all of the common stock of Lifecore Biomedical, Inc. ("Lifecore") under a Stock Purchase Agreement ("Purchase Agreement") in order to expand its product offerings and enter into new markets. Lifecore was a privately-held hyaluronan-based biomaterials company located in Chaska, Minnesota. Lifecore is principally involved in the development and manufacture of products utilizing hyaluronan, a naturally occurring polysaccharide that is widely distributed in the extracellular matrix of connective tissues in both animals and humans. In addition, Lifecore has licensed a sodium hyaluronate cross-linking technology from The Cleveland Clinic Foundation designed to provide a development vehicle for a product platform to introduce new products for the existing medical segments, as well as potentially new market segments. Furthermore, Lifecore is pursuing other development activities to utilize its fermentation and aseptic filling capabilities for non-hyaluronan based products.

Under the Purchase Agreement, the aggregate consideration payable by the Company to the former Lifecore stockholder at closing consisted of \$40.0 million in cash, which included \$6.6 million that is held in an escrow account to secure the indemnification rights of Landec and other indemnities with respect to certain matters, including breaches of representations, warranties and covenants included in the Purchase Agreement. The escrow account is in the name of the seller and Landec's right under the escrow agreement consist solely of its ability to file a claim against the escrow. In addition, the Company may be required to pay in cash up to an additional \$10.0 million in earnout payments based on Lifecore achieving certain revenue targets in calendar years 2011 and 2012.

The acquisition date fair value of the total consideration transferred was \$49.65 million, which consisted of the following (in thousands):

Cash	\$	40,000
Contingent consideration		9,650
Total	\$	49,650

The assets and liabilities of Lifecore were recorded at their respective estimated fair values as of the date of the acquisition using generally accepted accounting principles for business combinations. The excess of the purchase price over the fair value of the net identifiable assets acquired has been allocated to goodwill. Goodwill represents a substantial portion of the acquisition proceeds because the Lifecore trade name provides the Company with entry into the growing, higher margin hyaluronan product market. Management believes that there is further growth potential by extending Lifecore's product lines into new channels.

The following table summarizes the estimated fair values of Lifecore's assets acquired and liabilities assumed and related deferred income taxes, effective April 30, 2010, the date the Company obtained control of Lifecore. Changes to the fair values of the assets acquired and liabilities assumed may be recorded in future periods as the Company finalizes its estimates of the fair value (in thousands).

Cash and cash equivalents	\$	318
Accounts receivable, net		1,860
Inventories, net		9,009
Property and equipment		25,529
Other tangible assets		1,455
Intangible assets		7,900
Total identifiable assets acquired		46,071
Accounts payable and other liabilities		(2,983)
Long-term debt		(4,157)
Deferred taxes		(3,109)
Total liabilities assumed		(10,249)
Net identifiable assets acquired		35,822
Goodwill		13,828
Net assets acquired	\$	49,650

The Company used a combination of the market and cost approaches to estimate the fair values of the Lifecore assets acquired and liabilities assumed.

Inventory

A step-up in the value of inventory of \$523,000 was recorded in the allocation of the purchase price based on valuation estimates. During the three months ended August 29, 2010, \$162,000 of this step-up was charged to cost of products sold as the inventory was sold. As of August 29, 2010, \$269,000 of the step-up remained in inventory.

Intangible Assets

The Company identified two intangible assets in connection with the Lifecore acquisition: trade names valued at \$4.2 million, which is considered to be an indefinite life asset and therefore will not be amortized; and customer base valued at \$3.7 million with a twelve year useful life. The trade name intangible asset was valued using the relief from royalty valuation method and the customer relationship intangible asset was valued using the multi-period excess

earnings method.

Goodwill

The excess of the consideration transferred over the fair values assigned to the assets acquired and liabilities assumed was \$13.8 million, which represents the goodwill amount resulting from the acquisition which can be attributable to its long history and future prospects. None of the goodwill is expected to be deductible for income tax purposes. The Company will test goodwill for impairment on an annual basis or sooner, if deemed necessary. As of August 29, 2010, there were no changes in the recognized amount of goodwill resulting from the acquisition of Lifecore.

-9-

Liability for Contingent Consideration

In addition to the cash consideration paid to the former shareholder of Lifecore, the Company may be required to pay up to an additional \$10.0 million in earnout payments based on Lifecore achieving certain revenue targets in calendar years 2011 and 2012. The fair value of the liability for the contingent consideration recognized on the acquisition date was \$9.7 million and \$9.65 million, as of August 29, 2010 and May 30, 2010, respectively, and is classified as a non current liability in the Consolidated Balance Sheets. The Company determined the fair value of the liability for the contingent consideration based on a probability-weighted discounted cash flow analysis. This fair value measurement is based on significant inputs not observed in the market and thus represents a Level 3 measurement. The Company projects that it will pay the entire \$10 million earn out during the third quarter of fiscal year 2012.

3. 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 Direct® and Heartland Hybrid® 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 is being 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.

On December 1, 2006, Landec also entered into a five-year co-exclusive technology license and polymer supply agreement ("the Monsanto Agreement") with Monsanto for the use of Landec's Intellicoat polymer seed coating technology. Under the terms of the Monsanto Agreement, Monsanto agreed to pay Landec Ag \$2.6 million per year. The Monsanto Agreement was amended in November 2009. Under the terms of the amended Monsanto Agreement, Monsanto continues to have an exclusive license to use Landec's Intellicoat polymer technology for specific seed treatment applications. Over the remaining two-year term of the amended Monsanto Agreement, Monsanto will investigate uses of Landec's Intellicoat technology in a variety of seed categories in the field exclusively licensed to Monsanto.

Along with regaining the use of the Intellicoat technology outside of the specific applications licensed to Monsanto under the amended Monsanto Agreement, Landec has assumed responsibility for Landec Ag's operating expenses and realizes all the revenues and profits from the sales of existing and new Intellicoat seed coating products.

The Monsanto Agreement also provides for a fee payable to Landec Ag of \$4 million if Monsanto elects to terminate the Monsanto Agreement or \$10 million if Monsanto elects to purchase the rights to the exclusive field. If the purchase option is exercised before December 2011, or if Monsanto elects to terminate the Monsanto Agreement, all annual license fees and supply payments that have not been paid to Landec Ag will become due upon the purchase or termination. If Monsanto does not exercise its purchase option by December 2011 Landec Ag will receive the termination fee and all rights to the Intellicoat seed coating technology will revert to Landec. Accordingly, we will receive aggregate minimum guaranteed payments of \$17 million for license fees and polymer supply payments over five years or \$23 million in aggregate maximum payments if Monsanto elects to purchase the rights to the exclusive field. 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 \$6 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 rights to the exclusive field, a gain or loss on the sale will be recognized at the time of purchase. If Monsanto exercises its purchase option, we expect to enter into a new long-term supply agreement with Monsanto pursuant to which Landec would continue to be the exclusive supplier of Intellicoat polymer materials to Monsanto.

For each of the three months ended August 29, 2010 and August 30, 2009, Landec recognized \$1.35 million in revenue from the Monsanto Agreement.

-10-

4. Other License Agreements

In December 2005, Landec entered into an exclusive licensing agreement with Aesthetic Sciences whereby 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 under the agreement. Landec would also receive royalties on the sale of products incorporating Landec's technology. In addition, the Company received shares of preferred stock originally valued at \$1.3 million which represented a 19.9% ownership interest in Aesthetic Sciences as of December 2005.

As part of the original agreement with Aesthetic Sciences, Landec was to receive additional shares upon the completion of a specific milestone. In November 2006, that milestone was met and as a result Landec received an additional 800,000 shares of preferred stock originally valued at \$481,000. The receipt of the additional 800,000 preferred shares did not change Landec's 19.9% ownership interest in Aesthetic Sciences. During fiscal year 2009, Aesthetic Sciences completed a second preferred stock offering in which Landec did not participate and as a result Landec's ownership interest in Aesthetic Sciences was 17.3% as of August 29, 2010 and May 30, 2010. Aesthetic Sciences sold the rights to its Smartfil™ Injector System on July 16, 2010. Landec has evaluated its investment in Aesthetic Sciences for impairment, utilizing a discounted cash flow analysis under the terms of the purchase agreement. Based on the terms of the recent sale, the Company had determined that its investment was other than temporarily impaired and therefore recorded an impairment charge of \$1.0 million as of May 30, 2010. The Company's carrying value of its investment in Aesthetic Sciences of \$792,000 is included in other non current assets.

In March 2006, Landec entered into an exclusive license and research and development agreement with Air Products and Chemicals, Inc. ("Air Products"). Landec will provide research and development support to Air Products for three years with a mutual option for two additional years. The license fees are being recognized as license revenue over a three year period beginning March 2006. In addition, in accordance with the agreement, Landec receives 40% of the gross profit generated from the sale of products by Air Products occurring after April 1, 2007, that incorporate Landec's Intelimer materials.

In September 2007, the Company amended its licensing and supply agreement with Chiquita Brands International, Inc. ("Chiquita"). Under the terms of the amendment, the license for bananas was expanded to include additional exclusive fields using Landec's BreatheWay® packaging technology, and a new exclusive license was added for the sale and marketing of avocados and mangos using Landec's BreatheWay packaging technology. The agreement with Chiquita, which terminates in December 2011 (Chiquita has a five year renewal option), requires Chiquita to pay annual gross profit minimums to Landec in order for Chiquita to maintain its exclusive license for bananas, avocados and mangos. Under the terms of the agreement, Chiquita must notify Landec before December 1st of each year whether it is going to maintain its exclusive license for the following calendar year and thus agree to pay the minimums for that year. Landec was notified by Chiquita in November 2009 that Chiquita wanted to maintain its exclusive license for calendar year 2010 and thus agreed at that time to pay the minimum gross profit for calendar year 2010.

In June 2010, Apio entered into an exclusive license agreement with Windset Farms ("Windset") for Windset to utilize Landec's proprietary breathable packaging to extend the shelf life of greenhouse grown cucumbers, peppers and tomatoes ("exclusive products"). In accordance with the agreement, Apio received a one-time upfront research and development fee of \$100,000 and will receive license fees equal to 3% of net revenue of the exclusive products utilizing the proprietary breathable packaging technology, with or without the BreatheWay® trademark. The ongoing license fees are subject to annual minimums of \$150,000 for each of the three types of exclusive product as each is added to the exclusive agreement.

5. Stock-Based Compensation

In the three months ended August 29, 2010, the Company recognized stock-based compensation expense of \$506,000 or \$0.02 per basic and diluted share, which included \$244,000 for restricted stock unit awards and \$262,000 for stock option grants. In the three months ended August 30, 2009, the Company recognized stock-based compensation expense of \$220,000 or \$0.01 per basic and diluted share, which included \$119,000 for restricted stock unit awards and \$101,000 for stock option grants.

-11-

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

	Three Months Ended August 29, 2010	Three Months Ended August 30, 2009
Research and development	\$ 146,000	\$ 49,000
Sales, general and administrative	360,000	171,000
Total stock-based compensation	\$ 506,000	\$ 220,000

As of August 29, 2010, there was \$4.2 million 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 2.5 years for stock options and 2.4 years for restricted stock unit awards.

6. Net Income Per Diluted Share

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

	Three Months Ended August 29, 2010	Three Months Ended August 30, 2009
Numerator:		
Net income applicable to Common Stockholders	\$ 2,304	\$ 2,184
Denominator:		
Weighted average shares for basic net income per share	26,500	26,349
Effect of dilutive securities:		
Stock options and restricted stock units	219	367
Weighted average shares for diluted net income per share	26,719	26,716
Diluted net income per share	\$ 0.09	\$ 0.08

For the three months ended August 29, 2010 and August 30, 2009, the computation of the diluted net income per share excludes the impact of options to purchase 2.0 million shares and 881,613 shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

7. Income Taxes

The estimated annual effective tax rate for fiscal year 2011 is currently expected to be approximately 37%. The provision for income taxes for the three months ended August 29, 2010 was \$1.4 million.

As of May 30, 2010, the Company had unrecognized tax benefits of approximately \$868,000. Included in the balance of unrecognized tax benefits as of May 30, 2010 is approximately \$708,000 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 accounting guidance, the Company has decided to classify interest and penalties related to uncertain tax positions as a component of its provision for income taxes. The Company did not accrue interest and penalties relating to the income tax on the unrecognized tax benefits as of August 29, 2010 and May 30, 2010 as the amounts were not significant.

Due to tax attribute carryforwards, the Company is subject to examination for tax years 1994 forward for U.S. tax purposes. The Company was also subject to examination in various state jurisdictions for tax years 1998 forward, none of which were individually significant.

-12-

8. Goodwill and Other Intangibles

The Company's intangible assets are comprised of customer relationships with an estimated useful life of twelve years and trademarks/trade names and goodwill with indefinite lives (collectively, "intangible assets"), which the Company recognized in accordance with accounting guidance (i) upon the acquisition of Lifecore in April 2010, our HA-based Biomaterials reporting unit, (ii) upon the acquisition of Apio in December 1999, which consists of our Food Products Technology and Export reporting units and (iii) from the repurchase of all non controlling interests in the common stock of Landec Ag in December 2006. Accounting guidance defines goodwill as "the excess of the cost of an acquired entity over the net of the estimated fair values of the assets acquired and the liabilities assumed at date of acquisition." All intangible assets, including goodwill, associated with the acquisitions of Lifecore and Apio were allocated to our HA-based Biomaterials reporting unit and our Food Products Technology reporting unit, respectively, pursuant to accounting guidance based upon the allocation of assets and liabilities acquired and consideration paid for each reporting unit. The consideration paid for the Export reporting unit approximated its fair market value at the time of acquisition, and therefore no intangible assets were recorded in connection with the Company's acquisition of this reporting unit. Goodwill associated with the Technology Licensing reporting unit consists entirely of goodwill resulting from the repurchase of the Landec Ag non controlling interests.

The Company tests its intangible assets for impairment at least annually, in accordance with accounting guidance. When evaluating indefinite-lived intangible assets for impairment, accounting guidance requires the Company to compare the fair value of the asset to its carrying value to determine if there is an impairment loss. When evaluating goodwill for impairment, accounting guidance 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 not considered impaired; thus application of the second step of the two-step approach under accounting guidance is not required. Application of the intangible assets impairment tests requires significant judgment by management, including identification of reporting units, assignment of assets and liabilities to reporting units, assignment of intangible assets to reporting units, and the determination of the fair value of each indefinite-lived intangible asset and reporting unit based upon projections of future net cash flows, discount rates and market multiples, which judgments and projections are inherently uncertain.

Property, plant and equipment and finite-lived intangible assets are reviewed for possible impairment whenever events or changes in circumstances occur that indicate that the carrying amount of an asset (or asset group) may not be recoverable. The Company's impairment review requires significant management judgment including estimating the future success of product lines, future sales volumes, revenue and expense growth rates, alternative uses for the assets and estimated proceeds from the disposal of the assets. The Company conducts quarterly reviews of idle and underutilized equipment, and reviews business plans for possible impairment indicators. Impairment occurs when the carrying amount of the asset (or asset group) exceeds its estimated future undiscounted cash flows and the impairment is viewed as other than temporary. When impairment is indicated, an impairment charge is recorded for the difference between the asset's book value and its estimated fair value. Depending on the asset, estimated fair value may be determined either by use of a discounted cash flow model or by reference to estimated selling values of assets in similar condition. The use of different assumptions would increase or decrease the estimated fair value of assets and would increase or decrease any impairment measurement.

The Company tested its indefinite-lived intangible assets and goodwill for impairment as of July 25, 2010 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, 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.

The Company uses the discounted cash flow (“DCF”) approach to develop an estimate of fair value. The DCF approach 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 market approach was not used to value the Food Products Technology, Hyaluronan-based Biomaterials and Technology Licensing reporting units (the “Reporting Units”) because insufficient market comparables exist to enable the Company to develop a reasonable fair value of its intangible assets due to the unique nature of each of the Company’s Reporting Units.

The DCF approach requires the Company to exercise judgment in determining 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. These net cash flows are discounted at a rate that reflects both the current return requirements of the market and the risks inherent in the specific investment.

-13-

The DCF associated with the Technology Licensing reporting unit is based on the Monsanto Agreement with Monsanto. Under the Monsanto Agreement, Monsanto has agreed to pay Landec Ag a license fee of \$2.6 million in cash per year for five years beginning in December 2006, and a fee of \$4.0 million if Monsanto elects to terminate the Agreement, or \$10.0 million if Monsanto elects to purchase the rights to the exclusive field. If the purchase option is exercised before December 2011, or if Monsanto elects to terminate the Monsanto Agreement, all annual license fees that have not been paid to Landec Ag will become due upon the purchase or termination. As of August 29, 2010, the fair value of the Technology Licensing reporting unit, as determined by the DCF approach, exceeded its book value, and therefore, no intangible asset impairment was deemed to exist.

The DCF associated with the Food Products Technology reporting unit is based on management's five-year projection of revenues, gross profits and operating profits by fiscal year and assumes a 37% effective tax rate for each year. Management takes into account the historical trends of Apio and the industry categories in which Apio operates along with inflationary factors, current economic conditions, new product introductions, cost of sales, operating expenses, capital requirements and other relevant data when developing its projection. As of August 29, 2010, the fair value of the Food Products Technology reporting unit, as determined by the DCF approach, exceeded its book value, and therefore, no intangible asset impairment was deemed to exist.

The fair value of indefinite and finite-lived intangible assets associated with our acquisition of Lifecore on April 30, 2010, was determined using a DCF model based on management's five-year projections of revenues, gross profits and operating profits by fiscal year and assumes a 33% effective tax rate for each year. Management takes into account the historical trends of Lifecore and the industry categories in which Lifecore operates along with inflationary factors, current economic conditions, new product introductions, cost of sales, operating expenses, capital requirements and other relevant data when developing its projection. The trade name intangible asset was valued using the relief from royalty valuation method and the customer relationship intangible asset was valued using the multi-period excess earnings method. The fair value of goodwill was calculated as the excess of consideration paid, including the fair value of contingent consideration under the terms of the purchase agreement, over the fair value of the tangible and intangible assets acquired less liabilities assumed. The Company updated its analysis of the fair value of the indefinite-lived intangible assets and goodwill as of its annual impairment analysis date, concluding that the fair value of the Hyaluronan-based Biomaterials reporting unit, as determined by the DCF approach, exceeded its book value, and therefore, no intangible asset impairment was deemed to exist. There were no impairment indicators identified by the Company in its analysis of impairment associated with the acquired finite-lived intangible assets.

9. Inventories

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

	August 29, 2010	May 30, 2010
Raw materials	\$ 6,586	\$ 6,868
Work in progress	3,158	2,013
Finished goods	8,326	7,226
Total	\$ 18,070	\$ 16,107

10. Debt

On April 30, 2010 in conjunction with the acquisition of Lifecore, Lifecore entered into a new \$20 million Credit Agreement with Wells Fargo Bank N.A. ("Wells Fargo") with a five year term that provides for equal monthly principal payments plus interest. All of Lifecore's assets, valued at approximately \$79 million as of August 29, 2010, have

been pledged to secure the debt incurred pursuant to the Credit Agreement. Landec is the guarantor of the debt.

On August 19, 2004, Lifecore issued variable rate industrial revenue bonds ("IRB"). These bonds were assumed by Landec in the acquisition of Lifecore (see Note 2). The bonds are collateralized by a bank letter of credit which is secured by a first mortgage on the Company's facility in Chaska, Minnesota. In addition, the Company pays an annual remarketing fee equal to 0.125% and an annual letter of credit fee of 0.50%.

The Credit Agreement and the IRB contain certain restrictive covenants, which require Lifecore to meet certain financial tests, including minimum levels of net income, minimum quick ratio, minimum fixed coverage ratio and maximum capital expenditures.

On August 9, 2010 and September 14, 2010, the Company amended its Credit Agreement with Wells Fargo to modify certain financial covenants. As of August 29, 2010, the Company was in compliance with all covenants.

Long-term debt consists of the following (in thousands):

	August 29, 2010	May 30, 2010
Credit agreement with Wells Fargo; due in monthly payments of \$333,333 through April 30, 2015 with interest payable monthly at Libor plus 2% per annum	\$ 19,000	\$ 19,667
Industrial revenue bond issued by Lifecore; due in annual payments through 2020 with interest at a variable rate set weekly by the bond remarketing agent (0.50% and 2.56% at August 29, 2010 and May 30, 2010, respectively)	4,155	4,103
Total	23,155	23,770
Less current portion	(4,329)	(4,521)
Long-term portion	\$ 18,826	\$ 19,249

The maturities on the IRB are held in a sinking fund account, recorded in Prepaid expenses and other current asset in the accompanying Consolidated Balance Sheets and is paid out each year on September 1st.

11. Derivative Financial Instruments

The Company is exposed to interest rate risks primarily through borrowings under its Credit Agreement with Wells Fargo (see Note 10). Interest on all of the Company's borrowings under its Credit Agreement is based upon variable interest rates. As of August 29, 2010, the Company had borrowings of \$19.0 million outstanding under its Credit Agreement which bear interest at a rate equal to the one-month LIBOR plus 2%. As of August 29, 2010, the interest rate on borrowings under the Credit Agreement was accruing at 2.375%.

In May 2010, the Company entered into a five-year interest rate swap agreement under the Company's Credit Agreement which expires on April 30, 2015. The interest rate swap was designated as a cash flow hedge of future interest payments of LIBOR and has a notional amount of \$20 million. As a result of the interest rate swap transaction, the Company fixed for a five-year period the interest rate at 4.24% subject to market based interest rate risk on \$20 million of borrowings under its Credit Agreement. The Company's obligations under the interest rate swap transaction as to the scheduled payments were guaranteed and secured on the same basis as is its obligations under the Credit Agreement. As of August 29, 2010, the Company recorded to Other Comprehensive Loss on the Consolidated Balance Sheets an unrealized loss of \$331,000, net of taxes of \$210,000, as a result of the interest rate swap. The unrealized loss was based on Level 2 hierarchy for fair value measurements. If the interest rate swap is terminated or the debt borrowed is paid off prior to April 30, 2015, the amount of unrealized loss or gain included in Other Comprehensive Income (Loss) would be reclassified to earnings. The Company has no intentions of terminating the interest rate swap or prepaying the debt in the next twelve months. The interest rate swap liability is included in other non current liabilities as of August 29, 2010 and May 30, 2010.

12. 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 29, 2010 and May 30, 2010 and for the three months ended August 29, 2010 and August 30, 2009.

Apio's domestic commodity vegetable business was sold to Beachside Produce in 2003. The Apio Chairman is a 12.5% owner in Beachside Produce. During the three months ended August 29, 2010 and August 30, 2009, the Company recognized revenues of \$183,000 and \$210,000, 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 29, 2010 and May 30, 2010.

-15-

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

13. Comprehensive Loss

Comprehensive loss consists of net income and other comprehensive income for which Landec includes changes in unrealized gains and losses on its interest rate swap with Wells Fargo Bank, N.A. Accumulated other comprehensive loss is reported as a component of stockholders' equity. For the three months ended August 29, 2010, the comprehensive loss from the unrealized loss on the interest rate swap, net of \$105,000 of income taxes, was \$152,000. There was no comprehensive income or loss for the three months ended August 30, 2009.

14. Stockholders' Equity

During the three months ended August 29, 2010, 17,519 shares of Common Stock were issued upon the vesting of restricted stock units and upon the exercise of options under the Company's equity plans.

During the three months ended August 29, 2010, the Company granted options to purchase 10,000 shares of common stock and 3,333 restricted stock unit awards.

As of August 29, 2010 the Company has reserved 3.6 million shares of Common Stock for future issuance under its current and former equity plans.

On July 14, 2010, the Company announced that the Board of Directors of the Company had approved the establishment of a stock repurchase plan which allows for the repurchase of up to \$10 million of the Company's Common Stock. The Company may repurchase its common stock from time to time in open market purchases or in privately negotiated transactions. The timing and actual number of shares repurchased is at the discretion of management of the Company and will depend on a variety of factors, including stock price, corporate and regulatory requirements, market conditions, the relative attractiveness of other capital deployment opportunities and other corporate priorities. The stock repurchase program does not obligate Landec to acquire any amount of its common stock and the program may be modified, suspended or terminated at any time at the Company's discretion without prior notice. During the three months ended August 29, 2010, the Company repurchased on the open market 66,000 shares of its Common Stock for \$362,000.

15.

Business Segment Reporting

Landec operates in four business segments: the Food Products Technology segment, the Export segment, the HA-based Biomaterials 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 Export segment consists of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia. The HA-based Biomaterials segment sells products utilizing hyaluronan, a naturally occurring polysaccharide that is widely distributed in the extracellular matrix of connective tissues in both animals and humans for medical use in the ophthalmic, orthopedic and veterinary markets. 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. The Company's international sales are primarily to Europe, Canada, Taiwan, Indonesia, China and Japan. Operations and identifiable assets by business segment consisted of the following (in thousands):

Three Months Ended August 29, 2010	Food Products Technology	Export	HA-based Biomaterials	Technology Licensing	Corporate	TOTAL
Net sales	\$ 40,558	\$ 16,483	\$ 6,385	\$ 1,527	\$ —	\$ 64,953
International sales	\$ 4,605	\$ 16,446	\$ 4,433	\$ ¾	\$ ¾	\$ 25,484
Gross profit	\$ 6,363	\$ 932	\$ 2,995	\$ 1,527	\$ —	\$ 11,817
Net income (loss)	\$ 3,603	\$ 377	\$ 694	\$ 572	\$ (2,942)	\$ 2,304
Depreciation and amortization	\$ 783	\$ 2	\$ 484	\$ 37	\$ —	\$ 1,306
Interest income	\$ 29	\$ —	\$ 26	\$ —	\$ 52	\$ 107
Interest expense	\$ 2	\$ —	\$ 225	\$ —	\$ —	\$ 227
Income tax expense	\$ —	\$ —	\$ —	\$ —	\$ 1,352	\$ 1,352

Three Months Ended August 30, 2009

Net sales	\$ 41,856	\$ 17,702	\$ —	\$ 1,385	\$ —	\$ 60,943
International sales	\$ 3,436	\$ 15,950	\$ —	\$ ¾	\$ ¾	\$ 19,386
Gross profit	\$ 6,381	\$ 1,104	\$ —	\$ 1,385	\$ —	\$ 8,870
Net income (loss)	\$ 3,398	\$ 578	\$ —	\$ 740	\$ (2,532)	\$ 2,184
Depreciation and amortization	\$ 716	\$ 3	\$ —	\$ 43	\$ —	\$ 762
Interest income	\$ 32	\$ —	\$ —	\$ —	\$ 256	\$ 288
Interest expense	\$ 1	\$ —	\$ —	\$ —	\$ —	\$ 1
Income tax expense	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —