

LANDEC CORP \CA\  
Form 10-K  
August 01, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-K**

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

For the Fiscal Year Ended May 25, 2014, or

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

For the Transition period for \_\_\_\_\_ 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)

Registrant's telephone number, including area code:

**(650) 306-1650**

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock	The NASDAQ Global Select Stock Market

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes \_\_\_ No X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes \_\_\_ No X

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Act 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 the past 90 days.

Yes X 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 X No \_\_\_



Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 Act).

Yes  No

The aggregate market value of voting stock held by non-affiliates of the Registrant was approximately \$294,141,000 as of November 24, 2013, the last business day of the registrant's most recently completed second fiscal quarter, based upon the closing sales price on The NASDAQ Global Select Market reported for such date. Shares of Common Stock held by each officer and director and by each person who owns 10% or more of the outstanding Common Stock have been excluded from such calculation in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of July 18, 2014, there were 26,839,725 shares of Common Stock outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement relating to its October 2014 Annual Meeting of Stockholders which statement will be filed not later than 120 days after the end of the fiscal year covered by this report, are incorporated by reference in Part III hereof.



**LANDEC CORPORATION**

## ANNUAL REPORT ON FORM 10-K

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## **PART I**

### **Item 1. Business**

This report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. Words such as “projected,” “expects,” “believes,” “intends,” “assumes” and similar expressions are used to identify forward-looking statements. These statements are made based upon current expectations and projections about our business and assumptions made by our management and are not guarantees of future performance, nor do we assume any obligation to update such forward-looking statements after the date this report is filed. Our actual results could differ materially from those projected in the forward-looking statements for many reasons, including the risk factors listed in Item 1A. “Risk Factors” and the factors discussed below.

### **Corporate Overview**

Landec Corporation and its subsidiaries (“Landec” or the “Company”) design, develop, manufacture and market differentiated products in food and biomedical materials markets and license technology applications to partners. The Company is focused on health and wellness solutions and applications within the packaged food and biomaterial markets. In our Apio, Inc. (“Apio”) food business, we are committed to offering healthy, fresh produce products conveniently packaged to consumers. Apio also exports whole fruit and vegetables, predominantly to Asia through its subsidiary, Cal Ex Trading Company (“Cal-Ex”). In our Lifecore Biomedical, Inc. (“Lifecore”) biomedical materials business, we commercialize products that enable people to stay more active as they grow older.

Landec’s food and biomedical materials businesses utilize polymer chemistry technology, a key differentiating factor. Both core businesses focus on business-to-business selling such as selling directly to retail grocery store chains and club stores for Apio and directly to large ophthalmic suppliers for Lifecore. Both core businesses also benefit from the momentum that underlies consumer interest in healthy living - eating better and staying active.

Within our two core businesses, Landec has three operating segments – Food Products Technology, Food Export and HA-based Biomaterials, each of which is described below. Financial information concerning each of these segments for fiscal years 2014, 2013 and 2012 is summarized in Note 14 to the Consolidated Financial Statements.

Apio operates our Food Products Technology business, which combines our proprietary BreatheWay® food packaging technology with the capabilities of a large national food supplier and value-added produce processor which sells products under the Eat Smart® and GreenLine® brands. In Apio’s value-added operations, produce is processed



by trimming, washing, mixing, and packaging in bags and trays that in most cases incorporate Landec's BreatheWay membrane technology. The BreatheWay membrane increases shelf life and reduces shrink (waste) for retailers and helps ensure that consumers receive fresh produce by the time the product makes its way through the supply chain. Apio also licenses the BreatheWay technology to partners such as Chiquita Brands International, Inc. ("Chiquita") for packaging and distribution of bananas and to Windset Holding 2010 Ltd., a Canadian corporation ("Windset"), for packaging of greenhouse grown cucumbers and peppers.

Apio also operates the Food Export business. The Food Export business purchases and sells whole fruit and vegetable products predominantly to Asian markets.

Lifecore operates our Biomaterials business and is principally involved in the manufacture of pharmaceutical-grade sodium hyaluronate ("HA") products. Sodium hyaluronate is a naturally occurring polysaccharide that is widely distributed in the extracellular matrix in animals and humans. Based upon Lifecore's expertise working with highly viscous HA, the Company also specializes in aseptic filling services, as a contract development and manufacturing organization (CDMO), for difficult to handle (viscous) medicines filled in finished dose syringes.

Landec was incorporated in California on October 31, 1986 and reincorporated as a Delaware corporation on November 6, 2008. Our common stock is listed on The NASDAQ Global Select Market under the symbol "LNDC".

## **Technology Overview**

The Company has two proprietary polymer technology platforms: 1) Intelimer® materials which are the key technology behind our BreatheWay membrane technology, and 2) hyaluronan biopolymers. The Company's materials are generally proprietary as a result of being patented or due to being specially formulated for specific customers to meet specific commercial applications and/or specific regulatory requirements. The Company's polymer technologies, its customer relationships and trade names and its strong channels of distribution, are the foundation and key differentiating advantages on which Landec has built its business.

### ***A) Intelimer Polymers***

Intelimer polymers are crystalline, hydrophobic polymers that use a temperature switch to control and modulate properties such as viscosity, permeability and adhesion when varying the materials' temperature above and below the temperature switch. The sharp temperature switch is adjustable at relatively low temperatures (0°C to 100°C) and the changes resulting from the temperature switch are relatively easy to maintain in industrial and commercial environments. 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 liquid state.

Landec's proprietary polymer technology is based on the structure and phase behavior of Intelimer materials. The abrupt thermal transitions of specific Intelimer materials are achieved through the controlled use of hydrocarbon side chains that are attached to a polymer backbone. Below a pre-determined switch temperature, the polymer's side chains align through weak hydrophobic interactions resulting in a crystalline structure. When this side chain crystallizable polymer is heated to, or above, this switch temperature, these interactions are disrupted and the polymer is transformed into an amorphous, viscous state. Because this transformation involves a physical and not a chemical change, this process can be repeatedly reversible. Landec can set the polymer switch temperature anywhere between 0°C to 100°C by varying the average length of the side chains.

Landec's Intelimer materials are readily available and are generally synthesized from long side-chain acrylic monomers that are derived primarily from natural materials such as coconut and palm oils that are highly purified and designed to be manufactured economically through known synthetic processes. These acrylic-monomer raw materials are then polymerized by Landec leading to many different side-chain crystallizable polymers whose properties vary depending upon the initial materials and the synthetic process. Intelimer materials can be made into many different forms, including films, coatings, microcapsules and discrete forms. Intelimer polymers are the coatings on the substrate used to form our BreatheWay membranes.

*BreatheWay Membrane Packaging*

Certain types of fresh-cut and whole produce can spoil or discolor rapidly when packaged in conventional packaging materials and, therefore, are limited in their ability to be distributed broadly to markets. The Company's proprietary BreatheWay packaging technology utilizes Landec's Intelimer polymer technology to naturally extend the shelf life and quality of fresh-cut and whole produce.

After harvesting, vegetables and fruit continue to respire, consuming oxygen and releasing carbon dioxide. Too much or too little oxygen can result in premature spoilage and decay. The respiration rate of produce varies for each fruit and vegetable. Conventional packaging films used today, such as polyethylene and polypropylene, can be made with modest permeability to oxygen and carbon dioxide, but often do not provide the optimal atmosphere for the packaged produce. To achieve optimal product performance, each fruit or vegetable requires its own unique package atmosphere conditions. The challenge facing the industry is to develop packaging that meets the highly variable needs that each product requires in order to achieve value-creating performance. The Company believes that its BreatheWay packaging technology possesses all of the critical functionalities required to serve this diverse market. In creating a product package, a BreatheWay membrane is applied over a small cutout section or an aperture of a flexible film bag or plastic tray. This highly permeable "window" acts as the mechanism to provide the majority of the gas transmission requirements for the entire package. These membranes are designed to provide three principal benefits:

*High Permeability.* Landec's BreatheWay packaging technology is designed to permit transmission of oxygen and carbon dioxide at 300 to 1,000 times the rate of conventional packaging films. The Company thinks that these higher permeability levels will facilitate the packaging diversity required to market many types of fresh-cut and whole produce in many package sizes and configurations.

*Ability to Adjust Oxygen and Carbon Dioxide Ratios.* BreatheWay packaging can be tailored with carbon dioxide to oxygen transfer ratios ranging from 1.0 to 12.0 to selectively transmit oxygen and carbon dioxide at optimum rates to sustain the quality and shelf life of packaged produce. Other high permeability packaging materials, such as micro-perforated films cannot differentially control carbon dioxide permeability resulting in sub-optimal package atmosphere conditions for many produce products.

*Temperature Responsiveness.* Landec has developed breathable membranes that can be designed to increase or decrease permeability in response to environmental temperature changes. The Company has developed packaging that responds to higher oxygen requirements at elevated temperatures but is also reversible, and returns to its original state as temperatures decline. As the respiration rate of fresh produce also increases with temperature, the BreatheWay membrane's temperature responsiveness allows packages to compensate for the change in produce respiration by automatically adjusting gas permeation rates. By doing so, detrimental package atmosphere conditions are avoided and improved quality is maintained through the distribution chain.

## ***B) Sodium Hyaluronate (HA)***

Sodium hyaluronate is a non-crystalline, hydrophilic polymer that exists naturally as part of the extracellular matrix in many tissues within the human body, most notably within the aqueous humor of the eye, synovial fluid, skin and umbilical cord. The viscoelastic properties and water solubility of HA make it ideal for medical applications where space maintenance, lubricity or tissue protection are critical. Because of its widespread presence in tissues, its critical role in normal physiology, and its high degree of biocompatibility, the Company believes that hyaluronan will continue to be used in existing applications and for an increasing variety of other medical applications.

Sodium hyaluronate can primarily be produced in two ways, either through bacterial fermentation or through extraction from rooster combs. Lifecore produces HA only from fermentation, using an extremely efficient microbial fermentation process and a highly effective purification operation.

Sodium hyaluronate was first demonstrated to have commercial medical utility as a viscoelastic solution in cataract surgery. In this application, it is used for maintaining the space in the anterior chamber and protecting corneal tissue

during the removal and implantation of intraocular lenses. The first ophthalmic HA product, produced by extraction from rooster comb tissue, became commercially available in the United States in 1981. In 1985, Lifecore introduced the bacterial fermentation process to manufacture premium HA and received patent protection until 2002. HA-based products, produced either by rooster comb extraction or by fermentation processes such as Lifecore's, have since gained widespread acceptance in ophthalmology and are currently used in the majority of cataract extraction procedures in the world. HA has also become a significant component in several products used in orthopedics. Lifecore's HA is used as a viscous carrier for allogeneic freeze-dried demineralized bone used in spinal surgery, and as the active component of devices to treat the symptoms of osteoarthritis, and as a component to provide increased lubricity to medical devices. Lifecore's HA has also been utilized in veterinary drug applications to treat traumatic arthritis.

### **Description of Business Segments**

In this Description of Business Segments section, "Apio" and the "Food Products Technology business" will be used interchangeably; however, when describing Apio's export business it will be referred to as the "Food Export business".

***A) Food Products Technology Business***

The Food Products Technology business had revenues of \$361 million for the fiscal year ended May 25, 2014, \$320 million for the fiscal year ended May 26, 2013 and \$208 million for the fiscal year ended May 27, 2012.

Based in Guadalupe, California, Apio's primary business is fresh-cut and whole value-added products typically packaged in our proprietary BreatheWay packaging. Apio's fresh-cut value-added products business markets a variety of fresh-cut and whole vegetables to the top retail grocery chains, club stores and food service operators. During the fiscal year ended May 25, 2014, Apio shipped approximately twenty-nine million cartons of produce to its customers throughout North America, primarily in the United States.

Most vegetable products packaged in our BreatheWay packaging have 17 to 20 days of shelf life. In addition to packaging innovation, Landec's Apio food business develops innovative blends and combinations of vegetables that are sold in flexible film bags or rigid trays. More recently, the Company has launched a family of salad kits that are comprised of "superfood" mixtures of vegetables with healthy toppings/dressings. The launch of the first of these products called Sweet Kale Salad has broken all of Apio's records for speed of adoption with weekly sales of well over \$1 million as of May 2014. Additionally, we have launched several other superfood salad kits including Ginger Bok Choy, Apple Fennel, Kale and Chard Stir Fry and Shanghai Stir Fry, as examples. The Company's expertise includes accessing leading culinary experts and nutritionists nationally to help in the new product development process. We believe that our new products are "on trend" and strong market acceptance supports this belief. Recent statistics show that 39% of Americans are obese and 23% of Americans have diabetes. More and more consumers are beginning to make better food choices in their schools, homes and in restaurants and that is where our superfood products can fit into consumers daily healthy food choices.

In addition to proprietary packaging technology and a strong new product development pipeline, the Company has strong channels of distribution throughout North America with retail grocery store chains and club stores. Landec has one or more of its products in over 70% of all retail and club store sites in North America giving us a strong platform for introducing new products.

The Company sells its products under the nationally-known brands EatSmart® and GreenLine®. The Company also periodically licenses its BreatheWay packaging technology to partners such as Chiquita for packaging bananas and to Windset for packaging peppers and cucumbers that are grown hydroponically in greenhouses. The Company is engaged in the testing and development of other BreatheWay products. These packaging license relationships generate revenues either from product sales or royalties once commercialized.

**Apio Business Model**

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Landec is working with leaders in club stores, retail grocery chains and food service customers. The Company thinks it will have growth opportunities for the next several years through new customers and the introduction of innovative products in the United States, expansion of its existing customer relationships, and export and shipment of specialty packaged produce.

Landec manufactures its BreatheWay packaging through selected qualified contract manufacturers. In addition to using BreatheWay packaging for its value-added produce business, the Company markets and sells BreatheWay packaging directly to select partner food distributors.

There are five 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 branded and private label fresh-cut and whole value-added produce. It is focused on selling products under its Eat Smart and GreenLine brands and private label brands for its fresh-cut and whole value-added products. As retail grocery chains, club stores and food service operators 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 and during certain times of the year, enters into joint ventures with growers for produce. The year-round sourcing of produce is a key component to the fresh-cut and whole value-added processing business.

**Access to Customer Base:** Apio has strategically invested in the rapidly growing fresh-cut and whole value-added business. Apio's value-added processing plant in Guadalupe, CA, is automated with state-of-the-art vegetable processing equipment. Apio operates one large central processing facility in one of the lowest cost growing regions in California, the Santa Maria Valley, and for the majority of its non-green bean vegetable business, uses its packaging technology for nationwide delivery. With the acquisition of GreenLine, Apio now has three East Coast processing facilities and five East Coast distribution centers for nationwide delivery of green beans and recently Apio began processing non-green bean products in one of our East Coast processing facilities to meet the next-day delivery needs of customers.

**Expanded Product Line Using Technology and Unique Blends:** Apio, through the use of its BreatheWay packaging technology, is introducing 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 to snack packs. During the last twelve months, Apio has introduced eleven new unique products.



**Products Currently in Over 70% of U.S. Retail Grocery Stores:** With the acquisition of GreenLine, Apio now has products in over 70% of all U.S. retail grocery stores. This gives Apio the opportunity to cross sell Eat Smart value-added products to GreenLine customers and GreenLine value-added products to Eat Smart customers.

*Windset*

On February 15, 2011, Apio entered into a share purchase agreement (the “Purchase Agreement”) with Windset. Pursuant to the Purchase Agreement, Apio purchased 150,000 senior preferred shares for \$15 million and 201 common shares for \$201 (the “Purchased Shares”). The Company’s common shares represent a 20.1% interest in Windset. The non-voting senior preferred shares yield a cash dividend of 7.5% annually. The dividend is payable within 90 days of each anniversary of the execution of the Purchase Agreement. The Purchase Agreement includes a put and call option, which can be exercised on the sixth anniversary of the Purchase Agreement whereby Apio can exercise the put to sell its Purchased Shares to Windset, or Windset can exercise the call to purchase the Purchased Shares from Apio, in either case, at a price equal to 20.1% of the appreciation in the fair market value of Windset from the date of the Company’s investment through the put/call date, plus the purchase price of the Purchased Shares. Under the terms of the arrangement with Windset, the Company is entitled to designate one of five members on the Board of Directors of Windset. On July 15, 2014, the Company purchased an additional 6.8% of Windset common stock and 8.5% of Windset’s outstanding junior preferred stock for an aggregate price of \$11.0 million increasing its ownership to 26.9% of Windset’s common stock.

The Company thinks that hydroponically grown produce using Windset's know-how and growing practices will result in higher yields with competitive growing costs that will provide dependable year round supply to Windset's customers. In addition, the produce grown in Windset's greenhouses has a very high safety profile as no soil is used in the growing process. Windset owns and operates greenhouses in British Columbia, Canada and in Nevada and California. In addition to growing produce in their own greenhouses, Windset has numerous marketing arrangements with other greenhouse growers and utilizes buy/sell arrangements to meet fluctuation in demand from their customers.

### ***B) Food Export Business***

Food Export 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. The Food Export business is a commission-based buy/sell business that realizes a gross margin in the 5-8% range.

The Food Export business had revenues of \$70 million for the fiscal year ended May 25, 2014, \$79 million for the fiscal year ended May 26, 2013 and \$71 million for the fiscal year ended May 27, 2012.

Apio is strategically positioned with Cal-Ex to benefit from the growing population and wealth in Asia and other parts of the world over the next decade. Through Cal-Ex, Apio is currently one of the largest U.S. exporters of broccoli to Asia. Other large export items include apples, grapes, stonefruit and citrus.

### ***C) HA-based Biomaterials***

Our HA-based Biomaterials business operates through our Lifecore subsidiary. Lifecore had revenues of \$46 million for the fiscal year ended May 25, 2014, \$41 million for the fiscal year ended May 26, 2013 and \$34 million for the fiscal year ended May 27, 2012.

Lifecore operates our medical materials business and is principally involved in the manufacture of pharmaceutical-grade sodium hyaluronate products in the form of injectable products for ophthalmologic and orthopedic applications. There is now a greater percentage of Americans age 65 and older than at any other time in U.S. history and currently over 40 million Americans are 65 years of age or older and this trend is going to accelerate dramatically over the upcoming years. As our population ages, eye surgeries such as cataract surgeries, are going to increase. Additionally, patients will seek joint therapy as cartilage and soft tissue deteriorates. HA injections are a

primary course of treatment and Lifecore has built a leadership position in the markets it serves. It is estimated that there will be 22 million cataract surgeries in 2014 worldwide. Lifecore's expertise includes its ability to ferment, separate, purify, and aseptically fill HA for injectable product use. In addition to ophthalmic and orthopedic uses, veterinary medicine is another application for Lifecore's HA. Lifecore leverages its fermentation process to manufacture premium, pharmaceutical-grade HA and uses its aseptic filling capabilities to also deliver private-labeled HA finished products to its customers. Lifecore sells its products through partners in the U.S., Europe and South America. Lifecore has built its reputation as a premium supplier of HA.

Lifecore's products are primarily sold to strategic marketing partners for use in three medical areas: (1) Ophthalmic, (2) Orthopedic and (3) Veterinary. In addition, Lifecore provides product development services to its partners for HA-based, as well as non-HA based, fermented products and aseptically formulated products. These services include activities such as tech transfer, material component changes, analytical method development, pilot studies, stability studies, process validation, and clinical production.

By leveraging its fermentation process and aseptic formulation and filling expertise, Lifecore has become a leader in the supply of HA-based products for multiple applications, and has taken advantage of non-HA device and drug opportunities by leveraging its expertise in manufacturing and aseptic syringe filling capabilities. Elements of Lifecore's strategy include the following:

- *Establish strategic relationships with market leaders.* Lifecore will continue to develop applications for products with partners who have strong marketing, sales and distribution capabilities to end-user markets. Through its strong reputation and history of providing pharmaceutical grade HA and products, Lifecore has been able to establish long-term relationships with the market leading ophthalmic surgical companies, and leverages those partnerships to attract new relationships in other medical markets.

- *Expand medical applications for HA.* Due to the growing knowledge of the unique characteristics of HA, and the role it plays in normal physiology, Lifecore continues to identify and pursue opportunities for the use of HA in other medical applications, such as wound care, aesthetic surgery, drug delivery, device coatings and through pharmaceutical sales to academic and corporate research customers. As part of this effort, Lifecore continues to explore applications for its Corgel® Biohydrogel technology licensed from the Cleveland Clinic Foundation. Further applications may involve expanding process development activity and/or additional licensing of technology.
- *Utilize manufacturing infrastructure to pursue contract aseptic filling and fermentation opportunities.* Lifecore has made strategic capital investments in its contract manufacturing and development business focusing on extending its aseptic filling capacity and capabilities. It is investing in this segment to meet increasing partner demand and attract new contract filling opportunities. Lifecore is using its manufacturing capabilities to provide contract manufacturing and development services to its partners in the area of sterile pre-filled syringes and fermentation and purification requirements.
- *Maintain flexibility in product development and supply relationships.* Lifecore's vertically integrated development and manufacturing capabilities allow it to establish a variety of contractual relationships with global corporate partners. Lifecore's role in these relationships extends from supplying HA raw materials to providing tech transfer and development services to manufacturing aseptically-packaged, finished sterile products and to assuming full supply chain responsibilities.

## **Trademarks/Trade names**

Intelimer®, Landec®, Apio™, Eat Smart®, BreatheWay®, GreenLine®, Clearly Fresh™, Lifecore®, LUROC® and Ortholure™ are some of the trademarks or registered trademarks and trade names of the Company in the United States and other countries. This Annual Report on Form 10-K also refers to the trademarks of other companies.

## **Sales and Marketing**

Apio is supported by dedicated sales and marketing resources. Apio has 36 sales and marketing employees, located in central California and throughout the U.S., supporting the Food Products Technology business and the Food Export business. During fiscal years 2014, 2013 and 2012, sales to the Company's top five customers accounted for approximately 42%, 40% and 45%, respectively, of its revenues, with the top two customers, both from the Food Products Technology segment, Costco Wholesale Corporation which accounted for approximately 21%, 16%, and 17%, respectively, and Wal-mart, Inc. which accounted for approximately 11%, 13%, and 11%, respectively, of the

Company's revenues. A loss of either of these customers would have a material adverse effect on the Company's business.

Lifecore sells products to partners under supply agreements and also through distribution agreements. Excluding research sales, Lifecore does not sell to end users and, therefore, does not have the traditional infrastructure of a dedicated sales force and marketing employees and its name recognition allows Lifecore to attract new customers and offer its services with a minimal marketing and sales infrastructure.

### **Seasonality**

Apio's sales are seasonal. The Food Products Technology business can be affected by seasonal weather factors, such as the high cost of sourcing product due to a shortage of essential value-added produce items, which have impacted quarterly results in the past. The Food Export business also typically recognizes a much higher percentage of its revenues and profit during the first half of Landec's fiscal year compared to the second half. Lifecore's business is not significantly affected by seasonality.

## **Manufacturing and Processing**

### *Food Products Technology Business*

The manufacturing process for the Company's proprietary BreatheWay packaging products is comprised of polymer manufacturing, membrane manufacturing and label package conversion. A third party toll manufacturer currently makes virtually all of the polymers for the BreatheWay packaging system. Select outside contractors currently manufacture the breathable membranes, and Landec has transitioned virtually all of the label package conversion to Apio's Guadalupe facility to meet the increasing product demand and to provide additional developmental capabilities.

Apio processes virtually all of its fresh-cut, value-added non-green bean products in its processing facility located in Guadalupe, California. Cooling of produce is done through third parties and Apio Cooling LP, a separate consolidated subsidiary in which Apio has a 60% ownership interest and is the general partner.

Apio processes its fresh-cut, value-added green bean products, acquired with the acquisition of GreenLine in April 2012, in four processing plants located in Guadalupe, California; Bowling Green, Ohio; Hanover, Pennsylvania; and Vero Beach, Florida.

### *Hyaluronan-based Biomaterials Business*

The commercial production of HA by Lifecore requires fermentation, separation and purification capabilities. Products are supplied in a variety of bulk and single dose configurations.

Lifecore produces its HA through a bacterial fermentation process. Medical grade HA was initially commercially available only through an extraction process from rooster combs. Lifecore believes that the fermentation manufacturing approach is superior to rooster comb extraction because of greater efficiency and flexibility, a more favorable long-term regulatory environment, and better economies of scale in producing large commercial quantities. Today's HA competitors are primarily utilizing a fermentation process.

Lifecore's 114,000 square foot facility in Chaska, Minnesota is used primarily for the HA manufacturing process, formulation and aseptic syringe and bulk filling. The Company considers that the current inventory on-hand, together with its manufacturing capacity, will be sufficient to allow it to meet the needs of its current customers for the foreseeable future.

Lifecore provides versatility in the manufacturing of various types of finished products. It supplies several different forms of HA in a variety of molecular weight fractions as powders, solutions and gels, and in a variety of bulk and single-use finished packages. Lifecore continues to conduct development work designed to improve production efficiencies and expand its capabilities to achieve a wider range of HA product specifications in order to address the broadening opportunities for using HA in medical applications.

The FDA inspects the Company's manufacturing systems periodically and requires compliance with the FDA's Quality System Regulation ("QSR"). In addition, Lifecore's customers conduct intensive quality audits of the facility and its operations. Lifecore also periodically contracts with independent regulatory consultants to conduct audits of its operations. Similar to other manufacturers subject to regulatory and customer specific requirements, Lifecore's facility was designed to meet applicable regulatory requirements and has been cleared for the manufacturing of both device and pharmaceutical products. The Company maintains a Quality System which complies with applicable standards and regulations: FDA Medical Device Quality System requirements (21 CFR 820); FDA Drug Good Manufacturing Practices (21 CFR 210-211); European Union Good Manufacturing Practices (EudraLex Volume 4); Medical Device Quality Management System (ISO 13485); European Medical Device Directive; Canadian Medical Device Regulations; International Guide for Active Pharmaceutical Ingredients (ICH Q7), and Australian Therapeutic Goods Regulations). Compliance with these international standards of quality greatly assists in the marketing of Lifecore's products globally.

### *General*

Several of the raw materials used in manufacturing certain of the Company's products are currently purchased from a single source. Although to date the Company has not experienced difficulty acquiring materials for the manufacture of its products, no assurance can be given that interruptions in supplies will not occur in the future, that the Company will be able to obtain substitute vendors, or that the Company will be able to procure comparable materials at similar prices and terms within a reasonable time. Any such interruption of supply could have a material adverse effect on the Company's ability to manufacture and distribute its products and, consequently, could materially and adversely affect the Company's business, operating results and financial condition.

### **Research and Development**

Landec is focusing its research and development resources on both existing and new product applications. Expenditures for research and development for the fiscal years ended May 25, 2014, May 26, 2013 and May 27, 2012 were \$7.2 million, \$9.3 million and \$9.6 million, respectively. Research and development expenditures funded by corporate or governmental partners were zero during fiscal year 2014, \$688,000 during fiscal year 2013 and zero in fiscal year 2012. The Company may seek funds for applied materials research programs from U.S. government agencies as well as from commercial entities. The Company anticipates that it will continue to incur significant research and development expenditures in order to maintain its competitive position with a continuing flow of innovative, high-quality products and services. As of May 25, 2014, Landec had 61 employees engaged in research and development with experience in polymer and analytical chemistry, product application, product formulation, and mechanical and chemical engineering.

### **Competition**

The Company operates in highly competitive and rapidly evolving fields, and new developments are expected to continue at a rapid pace. Competition from large food processors, packaging companies, and medical and pharmaceutical companies is intense. Many of these competitors have substantially greater financial and technical resources and production and marketing capabilities than the Company, and many have substantially greater experience in conducting field trials, obtaining regulatory approvals and manufacturing and marketing commercial products. There can be no assurance that these competitors will not 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 the Company or that would render the Company's technology and products obsolete and non-competitive.



## **Patents and Proprietary Rights**

The Company's success depends in large part on its ability to obtain patents, maintain trade secret protection and operate without infringing on the proprietary rights of third parties. The Company has had 43 U.S. patents issued of which 28 remain active as of May 25, 2014 with expiration dates ranging from 2014 to 2028. There can be no assurance that any of the pending patent applications will be approved, that the Company will develop additional proprietary products that are patentable, that any patents issued to the Company will provide the Company with competitive advantages or will not be challenged by any third parties or that the patents of others will not prevent the commercialization of products incorporating the Company's technology. Furthermore, there can be no assurance that others will not independently develop similar products, duplicate any of the Company's products or design around the Company's patents. Any of the foregoing results could have a material adverse effect on the Company's business, operating results and financial condition.

The commercial success of the Company will also depend, in part, on its ability to avoid infringing patents issued to others. If the Company were determined to be infringing any third party patent, the Company could be required to pay damages, alter its products or processes, obtain licenses or cease certain activities. In addition, if patents are issued to others which contain claims that compete or conflict with those of the Company and such competing or conflicting claims are ultimately determined to be valid, the Company may be required to pay damages, to obtain licenses to these patents, to develop or obtain alternative technology or to cease using such technology. If the Company is required to obtain any licenses, there can be no assurance that the Company will be able to do so on commercially favorable terms, if at all. The Company's failure to obtain a license to any technology that it may require to commercialize its products could have a material adverse impact on the Company's business, operating results and financial condition.

## **Government Regulation**

Government regulation in the United States and other countries is a significant factor in the marketing of certain of the Company's products and in the Company's ongoing research and development activities. Some of the Company's products are subject to extensive and rigorous regulation by the FDA, which regulates some of the products as medical devices and which, in some cases, requires Pre-Market Approval ("PMA"), and by foreign countries, which regulate some of the products as medical devices or drugs. Under the Federal Food, Drug, and Cosmetic Act ("FDC Act"), the FDA regulates the clinical testing, manufacturing, labeling, distribution, sale and promotion of medical devices in the United States.

Other regulatory requirements are placed on the manufacture, processing, packaging, labeling, distribution, recordkeeping and reporting of a medical device and on the quality control procedures, such as the FDA's device QSR regulations. Manufacturing facilities are subject to periodic inspections by the FDA to assure compliance with device QSR requirements, along with pre-approval inspection (PAI) for PMA product introduction. Lifecore's facility is subject to inspections as both a device and a drug manufacturing operation. For PMA devices, the Company that owns the product submission is required to submit an annual report and to obtain approval of a PMA supplement for modifications to the device or its labeling. Other applicable FDA requirements include the medical device reporting ("MDR") regulation, which requires that the Company provide information to the FDA regarding deaths or serious injuries alleged to have been associated with the use of its devices, as well as product malfunctions that would likely cause or contribute to death or serious injury if the malfunction were to recur.

## **Employees**

As of May 25, 2014, Landec had 531 full-time employees, of whom 432 were dedicated to research, development, manufacturing, quality control and regulatory affairs and 99 were dedicated to sales, marketing and administrative activities. Landec intends to recruit additional personnel in connection with the development, manufacturing and marketing of its products. None of Landec's employees is represented by a union, and Landec considers its relationship with its employees to be good.

## **Available Information**

Landec's website is <http://www.landec.com>. Landec makes available free of charge its annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the SEC. Information contained on our website is not part of this Report.

**Item 1A. Risk Factors**

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 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.

***Lapses in disclosure controls and procedures or internal control over financial reporting could materially and adversely affect the Company’s operations, profitability or reputation.***

We are committed to maintaining high standards of internal control over financial reporting and disclosure controls and procedures. Nevertheless, lapses or deficiencies in disclosure controls and procedures or in our internal control over financial reporting may occur from time to time. On January 2, 2013, we reported that our audit committee reached a determination to restate our previously-filed interim financial statements for the quarter ended August 26, 2012 and that our previously-filed interim financial statements for the quarter ended August 26, 2012 should not be relied upon. We also reported management’s determination that a material weakness existed in our internal control over financial reporting at August 26, 2012. As a result of the material weakness, management also concluded that our disclosure controls and procedures were not effective at August 26, 2012.

There can be no assurance that our disclosure controls and procedures will be effective in preventing a material weakness or significant deficiency in internal control over financial reporting from occurring in the future. Any such lapses or deficiencies may materially and adversely affect our business and results of operations or financial condition, restrict our ability to access the capital markets, require us to expend resources to correct the lapses or deficiencies, expose us to regulatory or legal proceedings, harm our reputation, or otherwise cause a decline in investor confidence.

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

Our Food Products Technology business is subject to weather conditions that affect commodity prices, crop quality and yields, and decisions by growers regarding crops to be planted. Crop diseases and severe conditions, particularly weather conditions such as unexpected or excessive rain or other precipitation, unseasonable temperature fluctuations, 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. In fiscal year 2014, the Company's operating income was negatively impacted by approximately \$9.3 million in operational variances driven from produce quality and yield issues, higher labor costs and lower processing yields in the Food Products Technology business. Because a significant portion of the costs are fixed and contracted in advance of each operating year, volume declines reflecting production interruptions or other factors could result in increases in unit production costs which could result in substantial losses and weaken our financial condition.

***The Global Economy is Experiencing Continued Volatility, Which May Have an Adverse Effect on Our Business***

In recent years, the U.S. and international economy and financial markets experienced a significant slowdown and volatility due to uncertainties related to the availability of credit, energy prices, difficulties in the banking and financial services sectors, softness in the housing market, diminished market liquidity, geopolitical conflicts, falling consumer confidence and high unemployment rates. Ongoing volatility in the economy and financial markets could further lead to reduced demand for our products, which in turn, would reduce our revenues and adversely affect our business, financial condition and results of operations. In particular, volatility in the global markets have resulted in softer demand and more conservative purchasing decisions by customers, including a tendency toward lower-priced products, which could negatively impact our revenues, gross margins and results of operations. In addition to a reduction in sales, our profitability may decrease because we may not be able to reduce costs at the same rate as our sales decline. We cannot predict the ultimate severity or length of the current period of volatility, whether the recent signs of economic recovery will prove sustainable, or the timing or severity of future economic or industry downturns.

Given the current uncertain economic environment, our customers, suppliers and partners may have difficulties obtaining capital at adequate or historical levels to finance their ongoing business and operations, which could impair

their ability to make timely payments to us. This may result in lower sales and/or inventory that may not be saleable or bad debt expense for Landec. In addition to the impact of the current market uncertainty on our customers, some of our vendors and growers may experience a reduction in their availability of funds and cash flows, which could negatively impact their business as well as ours. A further worsening of the economic environment or continued or increased volatility of the U.S. economy, including increased volatility in the credit markets, could adversely impact our customers' and vendors' ability or willingness to conduct business with us on the same terms or at the same levels as they have historically. Further, this economic volatility and uncertainty about future economic conditions makes it challenging for Landec to forecast its operating results, make business decisions, and identify the risks that may affect its business, sources and uses of cash, financial condition and results of operations.

***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. Apio can be affected by seasonal and weather factors which have impacted our financial results due to a shortage of essential value-added produce items. In fiscal year 2014, operational variances driven from produce quality and yield issues, higher labor costs and lower processing yields in the Food Products Technology business had an approximate \$9.3 million negative impact on our operating income. Our earnings may also fluctuate based on our ability to collect accounts receivable from customers and notes receivable from growers and on price fluctuations in the fresh vegetable and fruit markets. Other factors that affect our operations include:

the seasonality and availability 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 and timing 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.

***Uncertainty Relating To Integration Of New Business Acquisitions.***

The successful integration of new business acquisitions, including the GreenLine acquisition, may require substantial effort from the Company's management. The diversion of the attention of management and any difficulties encountered in the transition process could have a material adverse effect on the Company's ability to realize the anticipated benefits of the acquisitions. The successful combination of new businesses also requires coordination of research and development activities, manufacturing, and sales and marketing efforts. In addition, the process of combining organizations located in different regions of the United States could cause the interruption of, or a loss of momentum in, the Company's activities. There can be no assurance that the Company will be able to retain key management, technical, sales and customer support personnel, or that the Company will realize the anticipated benefits of any acquisitions, and the failure to do so would have a material adverse effect on the Company's business, results of operations and financial condition.

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

Our success in generating significant sales of our products depends in part on our ability 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,

regulatory approvals,

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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 or our partners/customers are in the early stage of product commercialization of certain Intelimer-based specialty packaging, HA-based products and other Intelimer polymer products. We expect that our future growth will depend in large part on our or our partners/customers 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 companies will depend substantially on 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, industrial, medical and pharmaceutical 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.

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

Any disruptions in our primary manufacturing operation at Apio's facilities in Guadalupe, California or Bowling Green, Ohio or Lifecore's facility in Chaska, Minnesota 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 adversely 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. In addition, 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, substrate materials for our breathable membrane products and raw materials for our HA 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 their 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 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 FDA 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:

finances, 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 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. 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.

Our Food Products Technology business is subject to the Perishable Agricultural Commodities Act (“PACA”). 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.

Lifecore's existing products and its products under development are considered to be medical devices and therefore, require clearance or approval by the FDA before commercial sales can be made in the United States. The products also require the approval of foreign government agencies before sales may be made in many other countries. The process of obtaining these clearances or approvals varies according to the nature and use of the product. It can involve lengthy and detailed safety, efficacy and clinical studies, as well as extensive site inspections and lengthy regulatory agency reviews. There can be no assurance that any of the Company's clinical studies will show safety or effectiveness; that any of the Company's products that require FDA clearance or approval will obtain such clearance or approval on a timely basis, on terms acceptable to the Company for the purpose of actually marketing the products, or at all; or that following any such clearance or approval previously unknown problems will not result in restrictions on the marketing of the products or withdrawal of clearance or approval.

In addition, most of the existing products being sold by Lifecore and its customers are subject to continued regulation by the FDA, various state agencies and foreign regulatory agencies which regulate manufacturing, labeling and record keeping procedures for such products. Marketing clearances or approvals by these agencies can be withdrawn due to failure to comply with regulatory standards or the occurrence of unforeseen problems following initial clearance or approval. These agencies can also limit or prevent the manufacture or distribution of Lifecore's products. A determination that Lifecore is in violation of such regulations could lead to the imposition of civil penalties, including fines, product recalls or product seizures, injunctions, and, in extreme cases, criminal sanctions.

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.

### ***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 such 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.

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

For fiscal year 2014, approximately 29% 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 in 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 fiscal year 2014, sales to our top five customers accounted for approximately 42% of our revenues, with our two largest customers from our Food Products Technology segment, Costco Wholesale Corporation and Wal-mart, Inc. accounting for approximately 21% and 11%, respectively, 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 revenues. We may experience changes in the composition of our customer base as we have experienced in the past. 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 and Lifecore are sole sourced to 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. Such events 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 consider to be 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 think 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.

***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.

***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 undocumented workers 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 on 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 for an extended period 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.

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

The issuance of 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 dividends on our Common Stock since inception and do not expect to 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 stockholders’ equity. Goodwill arises when an acquirer pays more for a business than the fair value of the tangible and separately measurable intangible net assets. In accordance with accounting guidance, 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 reported profitability.

***Item 1B. Unresolved Staff Comments***

None.

**Item 2. Properties**

As of May 25, 2014, the Company owned or leased properties in Menlo Park and Arroyo Grande, Guadalupe California; Chaska, Minnesota; Bowling Green, Perrysburg and McClure, Ohio; Hanover, Pennsylvania; Vero Beach, Florida; Rock Hill, South Carolina and Rock Tavern, New York.

These properties are described below:

Location	Business Segment	Ownership	Facilities	Acres of Land	Lease Expiration
Menlo Park, CA	Corporate	Leased	14,600 square feet of office and laboratory space	—	12/31/16
Chaska, MN	HA-based Biomaterials	Owned	114,000 square feet of office, laboratory and manufacturing space	27.5	—
Guadalupe, CA	Food Products Technology	Owned	199,000 square feet of office space, manufacturing and cold storage	17.7	—
Bowling Green, OH	Food Products Technology	Owned	55,900 square feet of office space, manufacturing and cold storage	7.7	—
Hanover, PA	Food Products Technology	Owned	18,700 square feet of office space, manufacturing and cold storage	15.3	—
Vero Beach, FL	Food Products Technology	Leased	9,200 square feet of office space, manufacturing and cold storage	—	12/31/14
Rock Hill, SC	Food Products Technology	Owned	16,400 square feet of cold storage and office space	3.6	—
Rock Tavern, NY	Food Products Technology	Leased	7,700 square feet of cold storage and office space	—	8/23/23
McClure, OH	Food Products Technology	Leased	Farm land	185	12/31/14
Perrysburg, OH	Food Products Technology	Leased	9,000 square feet of office space	—	10/31/14
Guadalupe, CA	Food Products Technology	Leased	105,000 square feet of parking space	2.4	9/30/18
Guadalupe, CA	Food Products Technology	Leased	5,300 square feet of office space	—	5/31/17
Arroyo Grande, CA	Food Export	Leased	1,100 square feet of office space	—	Month-to-Month

The obligations of the Company under its credit agreement with BMO Harris Bank N.A. (“BMO Harris”) are secured by a lien on the Chaska, MN land and building. The obligations of the Company under its credit agreement with General Electric Capital Corporation (“General Electric”) are secured by a lien on all of the land and buildings of the Food Products Technology segment.

**Item 3. *Legal Proceedings***

As of the date of this report, the Company is not a party to any legal proceedings.

**Item 4. *Mine Safety Disclosures***

Not applicable.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Market Information**

The Common Stock is traded on The NASDAQ Global Select Market under the symbol "LNDC". The following table sets forth for each period indicated the high and low sales prices for the Common Stock.

<u>Fiscal Year Ended May 25, 2014</u>	High	Low
4 <sup>th</sup> Quarter ending May 25, 2014	\$12.16	\$10.19
3 <sup>rd</sup> Quarter ending February 23, 2014	\$12.62	\$10.08
2 <sup>nd</sup> Quarter ending November 24, 2013	\$13.57	\$11.34
1 <sup>st</sup> Quarter ending August 25, 2013	\$15.82	\$13.21

<u>Fiscal Year Ended May 26, 2013</u>	High	Low
4 <sup>th</sup> Quarter ending May 26, 2013	\$14.66	\$10.48
3 <sup>rd</sup> Quarter ending February 24, 2013	\$12.87	\$9.15
2 <sup>nd</sup> Quarter ending November 25, 2012	\$12.20	\$8.86
1 <sup>st</sup> Quarter ending August 26, 2012	\$9.96	\$6.72

**Holders**

There were approximately 57 holders of record of 26,839,725 shares of outstanding Common Stock as of July 18, 2014. Since certain holders are listed under their brokerage firm's names, the actual number of stockholders is higher.

**Dividends**

The Company has not paid any dividends on the Common Stock since its inception. The Company presently intends to retain all future earnings, if any, for its business and does not anticipate paying cash dividends on its Common Stock in the foreseeable future.

**Issuer Purchases of Equity Securities**

There were no shares repurchased by the Company during fiscal years 2014 or 2013. The Company may still repurchase up to \$3.8 million of the Company's Common Stock under the Company's stock repurchase plan announced on July 14, 2010.

**Item 6. *Selected Financial Data***

The information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with the information contained in Item 7 – "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and Notes to Consolidated Financial Statements contained in Item 8 of this report.

	Year	Year	Year	Year	Year
	Ended	Ended	Ended	Ended	Ended
	May 25,	May 26,	May 27,	May 29,	May 30,
	2014	2013	2012	2011	2010
Statement of Income Data: (in thousands)					
Product sales	476,813	441,708	317,552	276,729	238,224
Cost of product sales	414,249	378,948	265,414	230,034	204,458
Gross profit	62,564	62,760	52,138	46,695	33,766
Operating costs and expenses:					
Research and development	7,204	9,294	9,625	9,275	4,361
Selling, general and administrative	35,170	32,531	26,515	24,608	17,698
Other operating (income)/expenses	—	(3,933 )	1,421	4,780	3,725
Total operating costs and expenses	42,374	37,892	37,561	38,663	25,784
Operating profit	20,190	24,868	14,577	8,032	7,982
Dividend income	1,125	1,125	1,125	328	—
Interest income	260	179	180	430	834
Interest expense and other	(1,650 )	(2,008 )	(929 )	(820 )	(88 )
Other income	10,000	8,100	5,331	472	—
Net income before taxes	29,925	32,264	20,284	8,442	8,728
Income tax expense	(10,583 )	(9,452 )	(7,185 )	(4,181 )	(4,262 )
Consolidated net income	19,342	22,812	13,099	4,261	4,466
Non-controlling interest	(197 )	(225 )	(403 )	(341 )	(482 )
Net income applicable to common stockholders	\$19,145	\$22,587	\$12,696	\$3,920	\$3,984
Basic net income per share	\$0.72	\$0.87	\$0.49	\$0.15	\$0.15
Diluted net income per share	\$0.71	\$0.85	\$0.49	\$0.15	\$0.15
Shares used in per share computation:					
Basic	26,628	25,830	25,849	26,397	26,382
Diluted	27,120	26,626	26,126	26,626	26,633

May 25,    May 26,    May 27,    May 29,    May 30,  
2014        2013        2012        2011        2010



## Balance Sheet Data:

(in thousands)

Cash and cash equivalents	\$14,243	\$13,718	\$22,177	\$8,135	\$27,817
Total assets	313,623	290,942	277,692	206,312	200,197
Long-term debt	34,372	40,305	47,317	19,830	23,770
Retained earnings	71,554	52,409	29,822	17,126	13,206
Total stockholders' equity	\$203,069	\$178,693	\$149,742	\$136,055	\$130,784

**Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion should be read in conjunction with the Company's Consolidated Financial Statements contained in Item 8 of this report. 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 in Item 1A. "Risk Factors." Landec undertakes no obligation to revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this report.

## Overview

Landec Corporation and its subsidiaries (“Landec” or the “Company”) design, develop, manufacture and sell differentiated products for food and biomaterials markets and license technology applications to partners. The Company has two proprietary polymer technology platforms: 1) Intelimer® polymers, and 2) hyaluronan (“HA”) biopolymers. The Company’s HA biopolymers are proprietary in that they are specially formulated for specific customers to meet strict regulatory requirements. The Company’s polymer technologies, along with its customer relationships and trade names, are the foundation, and a key differentiating advantage upon which Landec has built its business. The Company sells specialty packaged branded Eat Smart and GreenLine and private label fresh-cut vegetables and whole produce to retailers, club stores and foodservice operators, primarily in the United States, Canada and Asia through its Apio, Inc. (“Apio”) subsidiary and sells HA-based biomaterials through its Lifecore Biomedical, Inc. (“Lifecore”) subsidiary.

Landec has three core businesses – Food Products Technology, Food Export, and HA-based Biomaterials. The Food Products Technology segment combines the Company’s BreatheWay packaging technology with Apio’s branded Eat Smart and GreenLine and private label fresh-cut and whole produce business. The Food Export business is operated through Apio’s Cal-Ex export company which purchases and sells whole fruit and vegetable products to predominantly Asian markets. The HA-based Biomaterials business sells products utilizing HA in the ophthalmic, orthopedic and veterinary segments and also supplies HA to customers pursuing other medical applications, such as aesthetic surgery, medical device coatings, tissue engineering and pharmaceuticals. See "Business - Description of Core Business".

As of May 25, 2014, the Company’s retained earnings were \$72 million. The Company may incur losses in the future. The amount of future net profits, if any, is uncertain and there can be no assurance that the Company will be able to sustain profitability in future years.

## Critical Accounting Policies and Use of Estimates

### *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 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 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.

*Allowance for Doubtful Accounts*

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The allowance for doubtful accounts is based on review of the overall condition of accounts receivable balances and review of significant past due accounts. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

*Inventories*

Inventories are stated at the lower of cost or market. If the cost of the inventories exceeds their expected market value, provisions are recorded currently for the difference between the cost and the market value. These provisions are determined based on specific identification for unusable inventory and an additional reserve, based on historical losses, for inventory currently considered to be usable.

### *Revenue Recognition*

Revenue from product sales is recognized when there is persuasive evidence that an arrangement exists, title has transferred, the price is fixed and determinable, and collectability is reasonably assured. Allowances are established for estimated uncollectible amounts, product returns, and discounts based on specific identification and historical losses.

Apio's Food Products Technology revenues generally consist of revenues generated from the sale of specialty packaged fresh-cut and whole value-added processed vegetable products that are generally washed and packaged in our proprietary packaging and sold under Apio's Eat Smart and GreenLine brands and various private labels. Revenue is generally recognized upon shipment of these products to customers. The Company takes title to all produce it trades and/or packages, and therefore, records revenues and cost of sales at gross amounts in the Consolidated Statements of Comprehensive Income

In addition, Food Products Technology 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 and from the sale of BreatheWay packaging to license partners. Revenue is recognized on the vegetable cooling operations as cooling and storage services are provided to our customers. Sales of BreatheWay packaging are recognized when shipped to our customers.

Apio's Food Export revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia by Cal-Ex. As most Cal-Ex customers are in countries outside of the U.S., title transfers and revenue is generally recognized upon arrival of the shipment in the foreign port. Apio records revenue equal to the sale price to third parties because it takes title to the product while in transit.

Our HA-based Biomaterials business principally generates revenue through the sale of products containing HA. Lifecore primarily sells products to customers in three medical areas: (1) Ophthalmic, which represented approximately 60% of Lifecore's revenues in fiscal year 2014, (2) Orthopedic, which represented approximately 20% of Lifecore's revenues in fiscal year 2014 and (3) Veterinary/Other. The vast majority of revenues from our HA-based Biomaterials business are recognized upon shipment.

A small amount of revenues from our HA-based Biomaterials business is related to contract research and development (R&D) services and multi-element arrangement services with customers where we provide products and/or services in a bundled arrangement.

Contract revenue R&D is recorded as earned, based on the performance requirements of the contract. Non-refundable contract fees for which no further performance obligations exist, and there is no continuing involvement by the Company, are recognized on the earlier of when the payments are received or when collection is assured.

For sales arrangements that contain multiple elements, the Company splits the arrangement into separate units of accounting if the individually delivered elements have value to the customer on a standalone basis. The Company also evaluates whether multiple transactions with the same customer or related party should be considered part of a multiple element arrangement, whereby the Company assesses, among other factors, whether the contracts or agreements are negotiated or executed within a short time frame of each other or if there are indicators that the contracts are negotiated in contemplation of each other. The Company then allocates revenue to each element based on a selling price hierarchy. The relative selling price for a deliverable is based on its vendor-specific objective evidence (VSOE), if available, third-party evidence (TPE), if VSOE is not available, or estimated selling price, if neither VSOE nor TPE is available. The Company then recognizes revenue on each deliverable in accordance with its policies for product and service revenue recognition. The Company is not typically able to determine VSOE or TPE, and therefore, uses estimated selling prices to allocate revenue between the elements of the arrangement.

The Company limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services or future performance obligations or subject to customer-specific cancellation rights. The Company evaluates each deliverable in an arrangement to determine whether they represent separate units of accounting. A deliverable constitutes a separate unit of accounting when it has stand-alone value, and for an arrangement that includes a general right of return relative to the delivered products or services, delivery or performance of the undelivered product or service is considered probable and is substantially controlled by the Company. The Company considers a deliverable to have stand-alone value if the product or service is sold separately by the Company or another vendor or could be resold by the customer. Further, the revenue arrangements generally do not include a general right of return relative to the delivered products. Where the aforementioned criteria for a separate unit of accounting are not met, the deliverable is combined with the undelivered element(s) and treated as a single unit of accounting for the purposes of allocation of the arrangement consideration and revenue recognition. The Company allocates the total arrangement consideration to each separable element of an arrangement based upon the relative selling price of each element. Allocation of the consideration is determined at arrangement inception on the basis of each unit's relative selling price. In instances where the Company has not established fair value for any undelivered element, revenue for all elements is deferred until delivery of the final element is completed and all recognition criteria are met.

Licensing revenue is recognized in accordance with prevailing accounting guidance. Initial license fees are deferred and amortized to revenue over the period of the agreement when a contract exists, the fee is fixed and determinable, and collectability is reasonably assured. Noncancellable, nonrefundable license fees are recognized over the period of the agreement, including those governing research and development activities and any related supply agreement entered into concurrently with the license when the risk associated with commercialization of a product is non-substantive at the outset of the arrangement.

From time to time, the Company offers customers sales incentives, which include volume rebates and discounts. These amounts are estimated on a quarterly basis and recorded as a reduction of revenue.

A summary of revenues by type of revenue arrangement as described above is as follows (in thousands):

	<b>Year ended</b>	<b>Year ended</b>
	<b>May 25, 2014</b>	<b>May 26, 2013</b>
Recorded upon shipment	\$398,938	\$359,518
Recorded upon acceptance in foreign port	69,710	78,442
Revenue from license fees, R&D contracts and royalties/profit sharing	1,354	1,975
Revenue from multiple element arrangements	6,811	1,773

TOTAL	\$476,813	\$441,708
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*Goodwill and Other Intangibles*

The Company's intangible assets are comprised of customer relationships with an estimated useful life of twelve to thirteen 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 GreenLine by Apio in April 2012, (ii) upon the acquisition of Lifecore in April 2010 and (iii) upon the acquisition of Apio in December 1999. 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 acquisition of Lifecore was allocated to our HA-based Biomaterials reporting unit and the acquisitions of Apio and GreenLine were allocated to our Food Products Technology reporting unit pursuant to accounting guidance based upon the allocation of assets and liabilities acquired and consideration paid for each reporting unit. As of May 25, 2014, the HA-based Biomaterials reporting unit had \$13.9 million of goodwill and the Food Products Technology reporting unit had \$35.7 million of goodwill.

The Company tests its indefinite-lived intangible assets for impairment at least annually, in accordance with accounting guidance. For non-goodwill indefinite-lived assets, the Company performs a qualitative analysis in accordance with ASC 350-30-35. For goodwill, the Company performs a quantitative analysis in accordance with ASC 350-20-35.

Application of the impairment tests for indefinite-lived intangible assets 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.

During the fiscal quarter ended February 23, 2014, the Company voluntarily changed the date of its annual goodwill and indefinite-lived intangible assets impairment testing from the last day of the fiscal month in July to the first day of the fiscal fourth quarter. This voluntary change is preferable under the circumstances as it provides the Company with additional time to complete its annual goodwill and indefinite-lived intangible asset impairment testing in advance of its year-end reporting and results in better alignment with the Company's strategic planning and forecasting process. The voluntary change in accounting principle related to the annual testing date will not delay, accelerate, or avoid an impairment charge. This change is not applied retrospectively as it is impracticable to do so because retrospective application would require application of significant estimates and assumptions with the use of hindsight. Accordingly, the change will be applied prospectively.

The Company tested its indefinite-lived intangible assets for impairment as of February 24, 2014 and determined that no adjustments to the carrying values of these 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 indefinite-lived 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 indefinite-lived intangible assets during the current period. The results of these tests could lead to write-downs of the carrying values of these assets in the current period.

The Company uses the discounted cash flow ("DCF") approach to develop an estimate of fair value for goodwill. 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 is not used to value the Company's reporting units because insufficient market comparables exist to enable the Company to develop a reasonable fair value due to the unique nature of each of the Company's reporting units.

The DCF associated with the annual goodwill impairment analysis for 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 36% effective tax rate for each year. Management takes into account the historical trends of the Food Products Technology reporting unit and the industry categories in which it 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 estimated fair value of the Food Products Technology reporting unit



as of February 24, 2014 was 136% of its book value at that date, therefore, no goodwill impairment was deemed to exist. For the test performed as of July 21, 2013, the projected cash flow from operations for determining the DCF for fiscal year 2014 was \$10.1 million for the Food Products Technology reporting unit. The actual cash flow from operations for fiscal year 2014 was \$10.5 million.

The DCF associated with the annual goodwill impairment analysis for the HA-based Biomaterials reporting unit is based on management's five-year projections of revenues, gross profits and operating profits by fiscal year and assumes a 36% effective tax rate for each year. Management takes into account the historical trends of HA-based Biomaterials reporting unit and the industry categories in which it 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 estimated fair value of the HA-based Biomaterials reporting unit as of February 24, 2014 was 176% of its book value at that date, therefore, no goodwill impairment was deemed to exist. For the test performed as of July 21, 2013, the projected cash flow from operations for determining the DCF for fiscal year 2014 was \$6.3 million for the HA-based Biomaterials reporting unit. The actual cash flow from operations for fiscal year 2014 was \$10.2 million. The difference of \$3.9 million is primarily due to timing of working capital changes and lower than planned intercompany charges for income taxes.

### *Income Taxes*

The Company accounts for income taxes in accordance with accounting guidance which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax basis of recorded assets and liabilities. The Company maintains valuation allowances when it is likely that all or a portion of a deferred tax asset will not be realized. Changes in valuation allowances from period to period are included in the Company's income tax provision in the period of change. In determining whether a valuation allowance is warranted, the Company takes into account such factors as prior earnings history, expected future earnings, unsettled circumstances that, if unfavorably resolved, would adversely affect utilization of a deferred tax asset, carryback and carryforward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. At May 25, 2014, the Company had a valuation allowance of \$881,000 against deferred tax assets.

In addition to valuation allowances, the Company establishes tax-contingency accruals for uncertain tax positions. The tax-contingency accruals are adjusted in light of changing facts and circumstances, such as the progress of tax audits, case law and emerging legislation. The Company recognizes interest and penalties related to uncertain tax positions as a component of income tax expense. The Company's effective tax rate includes the impact of tax-contingency accruals as considered appropriate by management.

A number of years may elapse before a particular matter, for which the Company has accrued, is audited and finally resolved. The number of years with open tax audits varies by jurisdiction. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, the Company believes its tax-contingency accruals are adequate to address known tax contingencies. Favorable resolution of such matters could be recognized as a reduction to the Company's effective tax rate in the year of resolution. Unfavorable settlement of any particular issue could increase the effective tax rate. Any resolution of a tax issue may require the use of cash in the year of resolution. The Company's tax-contingency accruals are presented in the balance sheet within accrued liabilities.

### *Stock-Based Compensation*

The Company's stock-based awards include stock option grants and restricted stock unit awards (RSUs).

The estimated fair value for stock options, which determines the Company's calculation of compensation expense, is based on the Black-Scholes pricing model. In addition, the accounting guidance requires the estimation of the

expected forfeitures of stock-based awards at the time of grant. As a result, the Company uses historical data to estimate pre-vesting forfeitures and records stock-based compensation expense only for those awards that are expected to vest and revises those estimates in subsequent periods if the actual forfeitures differ from the prior estimates.

### **Fair Value Measurements**

The Company uses fair value measurement accounting for financial assets and liabilities and for financial instruments and certain other items measured at fair value. The Company has elected the fair value option for its investment in a non-public company (see Note 4 to the Consolidated Financial Statements). The Company has not elected the fair value option for any of its other 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 May 25, 2014, the Company held certain assets and liabilities that are required to be measured at fair value on a recurring basis, including cash equivalents, marketable securities, interest rate swap and its minority interest investment in Windset.

The fair value of the Company’s marketable securities 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 marketable securities as a Level 1 measurement.

The fair value of the Company’s interest rate swap is determined based on model inputs that can be observed in a liquid market, including yield curves, and is categorized as a Level 2 measurement.

The Company has elected the fair value option of accounting for its investment in Windset. The calculation of fair value utilizes significant unobservable inputs in the discounted cash flow models, including projected cash flows, growth rates and discount rates. As a result, the Company’s investment in Windset is considered to be a Level 3 measurement investment. The change in the fair market value of the Company’s investment in Windset for the fiscal years ended May 25, 2014 and May 26, 2013 was due to the Company’s 20.1% minority interest in the change in the fair market value of Windset during those periods. In determining the fair value of the investment in Windset, the Company utilizes the following significant unobservable inputs in the discounted cash flow models:

	<u>At May 25, 2014</u>	<u>At May 26, 2013</u>		
Annual consolidated revenue growth rates	4%	3%	to	9%
Annual consolidated expense growth rates	4%	3%	to	8%
Consolidated income tax rates	15%			15%
Consolidated discount rates	16%	to	22 %	18% to 28%

The revenue growth, expense growth and income tax rate assumptions, consider the Company's best estimate of the trends in those items over the discount period. The discount rate assumption takes into account the risk-free rate of return, the market equity risk premium and the company’s specific risk premium and then applies an additional discount for lack of marketability of the underlying securities. The discounted cash flow valuation model used by the Company has the following sensitivity to changes in inputs and assumptions (in thousands):

	Impact on value of	
		Windset investment as of
		<u>May 25, 2014</u>
10% increase in revenue growth rates	\$	3,200
10% increase in expense growth rates	\$	(2,300 )
10% increase in income tax rates		—
10% increase in discount rates	\$	(1,500 )

Imprecision in estimating unobservable market inputs can affect the amount of gain or loss recorded for a particular position. The use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table summarizes the fair value of the Company's assets and liabilities that are measured at fair value on a recurring basis, as of May 25, 2014 and May 26, 2013 (in thousands):

	Fair Value at May 25, 2014			Fair Value at May 26, 2013		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
<b>Assets:</b>						
Marketable securities	\$-	\$-	\$-	\$1,545	\$-	\$-
Investment in private company	-	-	39,600	-	-	29,600
<b>Total</b>	<b>\$-</b>	<b>\$-</b>	<b>\$39,600</b>	<b>\$1,545</b>	<b>\$-</b>	<b>\$29,600</b>
<b>Liabilities:</b>						
Interest rate swap	-	44	-	-	163	-
<b>Total</b>	<b>\$-</b>	<b>\$44</b>	<b>\$-</b>	<b>\$-</b>	<b>\$163</b>	<b>\$-</b>

## Recent Accounting Pronouncements

### *Revenue Recognition*

In May 2014, the FASB issued Accounting Standard Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The standard requires entities to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new guidance also includes a cohesive set of disclosure requirements intended to provide users of financial statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a company's contracts with customers. ASU 2014-09 will be effective beginning the first quarter of the Company's fiscal year 2018 and early application is not permitted. The standard allows for either "full retrospective" adoption, meaning the standard is applied to all of the periods presented, or "modified retrospective" adoption, meaning the standard is applied only to the most current period presented in the financial statements. Management is currently evaluating the effect ASU 2014-09 will have on the Company's Consolidated Financial Statements and disclosures.

### *Unrecognized Tax Benefits*

In July 2013, the FASB issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, related to the presentation of unrecognized tax benefits. The update requires presentation of an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward in the statement of financial position. The guidance does not apply to the extent that a net operating loss carryforward or tax credit carryforward at the reporting date is not available under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position. The guidance is effective for fiscal years (and interim periods within those years) beginning after December 15, 2013, with early adoption permitted. The Company early adopted this standard in the first fiscal quarter of fiscal year 2014 and such adoption did not have a significant impact on the Company's Consolidated Financial Statements or disclosures.

## Results of Operations

*Fiscal Year Ended May 25, 2014 Compared to Fiscal Year Ended May 26, 2013*

**Revenues** (in thousands):

	<b>Fiscal Year ended</b>	<b>Fiscal Year ended</b>	<b>Change</b>	
	<b>May 25, 2014</b>	<b>May 26, 2013</b>		
<i><b>Food Products Technology</b></i>	\$360,728	\$320,447	13	%
<i><b>Food Export</b></i>	69,827	78,568	(11%)	)
<i><b>Total Apio</b></i>	430,555	399,015	8	%
<i><b>HA-based Biomaterials</b></i>	45,704	41,281	11	%
<i><b>Corporate</b></i>	554	1,412	(61%)	)
<i><b>Total Revenues</b></i>	\$476,813	\$441,708	8	%

*Food Products Technology (Apio)*

Apio's Food Products Technology 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 and GreenLine brands 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, and from the sale of BreatheWay packaging to license partners.

The increase in Apio's Food Products Technology revenues for the fiscal year ended May 25, 2014 compared to the same period last year was primarily due to a 8% increase in unit volume sales resulting primarily from expanded product offerings and a 10% unit volume increase in the fresh-cut vegetable category, according to Nielsen, coupled with new product introductions which typically have a higher price per unit than historical offerings.

*Food Export (Apio)*

Apio's Food Export revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia by Cal-Ex. Apio records revenue equal to the sale price to third parties because it takes title to the product while in transit.

The decrease in revenues in Apio's Food Export business for the fiscal year ended May 25, 2014 compared to the same period last year was due to a 6% decrease in unit volume sales primarily as a result of new Indonesian import quotas on fruit coupled with a product mix change to lower priced export items compared to fiscal year 2013.

*HA-based Biomaterials (Lifecore)*

Lifecore principally generates revenue through the sale of products containing HA. Lifecore primarily sells products to customers in three medical areas: (1) Ophthalmic, which represented approximately 60% of Lifecore's revenues in fiscal year 2014, (2) Orthopedic, which represented approximately 20% of Lifecore's revenues in fiscal year 2014 and (3) Veterinary/Other.



The increase in Lifecore's revenues for fiscal year 2014 compared to the same period last year was due to a 32% increase in revenues in Lifecore's aseptic filling business from increased sales to existing customers partially offset by a 13% decrease in fermentation sales.

### *Corporate*

Corporate revenues are generated from the licensing agreements with Air Products, Nitta and INCOTEC.

The decrease in Corporate revenues for fiscal year 2014 compared to the same period of last year was not significant.

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

	<b>Fiscal Year ended</b>	<b>Fiscal Year ended</b>	<b>Change</b>	
	<b>May 25, 2014</b>	<b>May 26, 2013</b>		
<i>Food Products Technology</i>	\$36,318	\$37,077	(2%	)
<i>Food Export</i>	5,340	5,274	1	%
<i>Total Apio</i>	41,658	42,351	(2%	)
<i>HA-based Biomaterials</i>	20,456	19,102	7	%
<i>Corporate</i>	450	1,307	(66%	)
<i>Total Gross Profit</i>	\$62,564	\$62,760	0	%

*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. The Company includes in cost of sales all of the costs related to the sale of products in accordance with U.S. generally accepted accounting principles. These costs include the following: raw materials (including produce, seeds, packaging, syringes and fermentation and purification supplies), direct labor, overhead (including indirect labor, depreciation, and facility related costs) and shipping and shipping-related costs. The following are the primary reasons for the changes in gross profit for the fiscal year ended May 25, 2014 compared to the same period last year as outlined in the table above.

*Food Products Technology (Apio)*

The decrease in gross profit for the Food Products Technology business for fiscal year 2014 compared to the same period last year was primarily due to much higher than expected operating costs including higher labor costs to meet higher than expected volumes and higher raw produce sourcing costs during primarily the first six months of fiscal year 2014 resulting from lower yields and poor quality due to a variety of factors, most importantly the heavy rains in the Midwest and along the East Coast and large temperatures swings in California throughout most of the year. The higher operating costs reduced Apio's gross profit by approximately \$9.3 million during fiscal year 2014 which was partially offset by the gross profit generated from the 13% increase in revenues.

*Food Export (Apio)*

Apio's Food Export business is a buy/sell business that typically realizes a gross margin in the 5-8% range.

The increase in gross profit for Apio's Food Export business for fiscal year 2014 compared to the same period last year was primarily due to favorable product mix changes to higher margin products, primarily into Indonesia, which resulted in a higher gross margin percentage during fiscal year 2014 of 7.6% compared to a gross margin percentage of 6.7% during fiscal year 2013. The favorable product mix was offset by the decrease in gross profit resulting from an 11% decrease in revenues.

*HA-based Biomaterials (Lifecore)*

Lifecore operates in the medical devices industry and has historically realized an overall gross margin percentage of approximately 45-50%.

The increase in gross profit for fiscal year 2014 compared to the same period last year was due to an 11%, or \$4.4 million increase in revenues resulting from the increased sales of both historical products and new products to existing customers. The increase in gross profit from higher revenues was partially offset by an unfavorable product mix change to higher sales of lower margin aseptically filled products from higher margin fermentation sales.

*Corporate*

The decrease in Corporate gross profit for fiscal year 2014 compared to the same period last year was not significant.

**Operating Expenses** (in thousands):

	<b>Fiscal Year ended</b>	<b>Fiscal Year ended</b>	<b>Change</b>	
	<b>May 25, 2014</b>	<b>May 26, 2013</b>		
<b>Research and Development:</b>				
<i>Apio</i>	\$1,105	\$1,088	2	%
<i>Lifecore</i>	4,739	4,930	(4)	%
<i>Corporate</i>	1,360	3,276	(58)	%
<b>Total R&amp;D</b>	\$7,204	\$9,294	(22)	%
<b>Selling, General and Administrative:</b>				
<i>Apio</i>	\$22,860	\$21,976	4	%
<i>Lifecore</i>	4,251	4,595	(7)	%
<i>Corporate</i>	8,059	5,960	35	%
<b>Total S,G&amp;A</b>	\$35,170	\$32,531	8	%
<b>Other operating expenses:</b>				
<i>Apio</i>	\$—	\$(3,933)		N/M
<b>Total Other Operating Expenses</b>	\$—	\$(3,933)		N/M

*Research and Development*

Landec's research and development consisted primarily of product development and commercialization initiatives. Research and development efforts at Apio are focused on the Company's proprietary BreatheWay membranes used for packaging produce, with a focus on extending the shelf-life of sensitive vegetables and fruit. In the Lifecore business, the research and development efforts are focused on new products and applications for HA-based biomaterials. For Corporate, the research and development efforts are focused on supporting the development and commercialization of new products and new technologies in our food and HA businesses along with developing uses for our proprietary Intelimer polymers outside of our food and HA businesses.

The decrease in research and development expenses for fiscal year 2014 compared to last year was primarily due to a decrease in Corporate R&D because of the Company transitioning away from R&D and licensing collaborations to maintain focus on R&D efforts at its core food and HA businesses.

*Selling, General and Administrative (S,G&A)*

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 S,G&A expenses for fiscal year 2014 compared to the same period last year was primarily due to an increase in accounting and tax fees, public company costs and board of director fees in fiscal year 2014.

*Other Operating Expenses*

Other operating expenses in fiscal year 2013 consisted of a \$3.9 million reversal of the earn-out liability at Apio associated with the GreenLine acquisition.

**Non-operating income/(expense)** (in thousands):

	<b>Fiscal Year ended</b>	<b>Fiscal Year ended</b>	<b>Change</b>	
	<b>May 25, 2014</b>	<b>May 26, 2013</b>		
<i>Dividend Income</i>	\$ 1,125	\$ 1,125	—	
<i>Interest Income</i>	\$ 260	\$ 179	45	%
<i>Interest Expense</i>	\$ (1,650 )	\$ (2,008 )	(18	%)
<i>Other Income</i>	\$ 10,000	\$ 8,100	23	%
<i>Income Taxes</i>	\$ (10,583 )	\$ (9,452 )	12	%
<i>Non controlling Interest</i>	\$ (197 )	\$ (225 )	(12	%)

*Dividend Income*

Dividend income is derived from the dividends accrued on our \$15 million preferred stock investment in Windset which yields a cash dividend of 7.5% annually. There was no change in dividend income in fiscal year 2014 compared to fiscal year 2013.

*Interest Income*

The increase in interest income for the fiscal year 2014 compared to the same period last year was not significant.

*Interest Expense*

The decrease in interest expense during fiscal year 2014 compared to the same period last year was due to the Company paying down its debt by \$9.9 million during fiscal year 2014.

*Other Income*

The increase in other income for fiscal year 2014 compared to the same period last year is primarily due to the change in the fair market value of our Windset investment being \$1.9 million higher in fiscal year 2014 compared to the increase in fiscal year 2013.

*Income Taxes*

The increase in the income tax expense for fiscal year 2014 was due to an increase in the effective tax rate for fiscal year 2014 to 36% compared to 30% in fiscal year 2013. The effective tax rates for last year was lower than this year as a result of the \$3.9 million earn out adjustment last year which was not subject to income tax. The increase in income taxes due to the increase in the effective tax rate was partially offset by a 7% decrease in net income before taxes compared to the same period last year.

*Non controlling Interest*

The non controlling interest consists of the limited partners' equity interest in the net income of Apio Cooling, LP.

The decrease in non controlling interest for fiscal year 2014 compared to the same period last year was not significant.

*Fiscal Year Ended May 27, 2013 Compared to Fiscal Year Ended May 27, 2012*

**Revenues** (in thousands):

	<b>Fiscal Year ended</b>	<b>Fiscal Year ended</b>	<b>Change</b>	
	<b>May 26, 2013</b>	<b>May 27, 2012</b>		
<b><i>Food Products Technology</i></b>	\$320,447	\$207,582	54	%
<b><i>Food Export</i></b>	78,568	71,485	10	%
<b><i>Total Apio</i></b>	399,015	279,067	43	%
<b><i>HA-based Biomaterials</i></b>	41,281	34,283	20	%
<b><i>Corporate</i></b>	1,412	4,202	(66	%)
<b><i>Total Revenues</i></b>	\$441,708	\$317,552	39	%

*Food Products Technology (Apio)*

Apio's Food Products Technology 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 and GreenLine brands 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 and from the sale of BreatheWay packaging to license partners.

The increase in Apio's Food Products Technology revenues for the fiscal year ended May 26, 2013 compared to the same period last year was primarily due to the following factors: (1) a \$27 million increase in non-green bean value-added sales due to a 15% increase in unit volume sales to existing non-green bean customers resulting primarily from expanded product offerings, gaining additional distribution locations and growth in the fresh-cut vegetable category, (2) an \$86 million increase in revenues from GreenLine which was acquired on April 23, 2012 and (3) a larger percentage of Apio's non-green bean value-added sales volume being generated from sales to club stores rather than retail grocery chains. These increases in revenue were partially offset by product mix changes in retail grocery chains to lower priced products from higher priced products.



*Food Export (Apio)*

Apio's Food Export revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia by Cal-Ex. Apio records revenue equal to the sale price to third parties because it takes title to the product while in transit.

The increase in revenues in Apio's Food Export business for the fiscal year ended May 26, 2013 compared to the same period last year was primarily due to more favorable pricing for export products in fiscal year 2013 compared to fiscal year 2012 resulting in higher prices per unit sold.

*HA-based Biomaterials (Lifecore)*

Lifecore principally generates revenue through the sale of products containing HA. Lifecore primarily sells products to customers in three medical areas: (1) Ophthalmic, which represented approximately 65% of Lifecore's revenues in fiscal year 2013, (2) Orthopedic, which represented approximately 20% of Lifecore's revenues in fiscal year 2013 and (3) Veterinary/Other.

The increase in Lifecore's revenues for fiscal year 2013 compared to the same period last year was due almost entirely to increased sales of existing aseptically filled products to existing customers and from new aseptically filled products recently approved by the FDA to existing customers in the Ophthalmic area.

*Corporate*

Corporate revenues are generated from the licensing agreements with Air Products, Nitta and INCOTEC.

The decrease in Corporate revenues for fiscal year 2013 compared to the same period of last year was due to the termination of the Monsanto Agreement at the end of the second quarter of fiscal year 2012. The Company recognized \$2.7 million in license fees from the Monsanto Agreement during fiscal year 2012. The Monsanto license fees were partially offset by research and development revenues from Nitta.

**Gross Profit** (in thousands):

	<b>Fiscal Year ended</b>	<b>Fiscal Year ended</b>	<b>Change</b>	
	<b>May 26, 2013</b>	<b>May 27, 2012</b>		
<i>Food Products Technology</i>	\$37,077	\$25,237	47	%
<i>Food Export</i>	5,274	4,900	8	%
<i>Total Apio</i>	42,351	30,137	41	%
<i>HA-based Biomaterials</i>	19,102	17,994	6	%
<i>Corporate</i>	1,307	4,007	(67	%)
<i>Total Gross Profit</i>	\$62,760	\$52,138	20	%

*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. The Company includes in cost of sales all of the costs related to the sale of products in accordance with U.S. generally accepted accounting principles. These costs include the following: raw materials (including produce, seeds, packaging, syringes and fermentation and purification supplies), direct labor, overhead (including indirect labor, depreciation, and facility related costs) and shipping and shipping-related costs. The following are the primary reasons for the changes in gross profit for the fiscal year ended May 26, 2013 compared to

the same period last year as outlined in the table above.

*Food Products Technology (Apio)*

The increase in gross profit for the Food Products Technology business for the fiscal year 2013 compared to the same period last year was primarily due to (1) the 54% increase in revenues and (2) the addition of higher margin GreenLine products. These increases were partially offset by the negative impact of produce sourcing issues which primarily occurred during the second half of fiscal year 2013.

*Food Export (Apio)*

Apio's Food Export business is a buy/sell business that typically realizes a gross margin in the 5-8% range.

The increase in gross profit for Apio's Food Export business for fiscal year 2013 compared to the same period last year was primarily due to a 10% increase in revenues partially offset by higher procurement costs for certain export products.

*HA-based Biomaterials (Lifecore)*

Lifecore operates in the higher margin medical devices industry and has historically realized an overall gross margin of approximately 45-50%.

The increase in gross profit for fiscal year 2013 compared to the same period last year was due to an increase in revenues of \$7.0 million resulting from the increased sales of both historical products and new products to existing customers which were partially offset by the revenue increase from aseptically filled products which have a lower gross margin than Lifecore's other products.

*Corporate*

The decrease in Corporate gross profit for fiscal year 2013 compared to the same period last year was due to the termination of the Monsanto Agreement at the end of the second quarter of fiscal year 2012. The Company recognized \$2.7 million in license fees from the Monsanto Agreement during fiscal year 2012. The Monsanto license fees were partially offset by research and development revenues from Nitta.

**Operating Expenses** (in thousands):

	<b>Fiscal Year ended</b>	<b>Fiscal Year ended</b>	<b>Change</b>	
	<b>May 26, 2013</b>	<b>May 27, 2012</b>		
<b><i>Research and Development:</i></b>				
<i>Apio</i>	\$1,088	\$1,106	(2	%)
<i>Lifecore</i>	4,930	4,671	6	%)
<i>Corporate</i>	3,276	3,848	(15	%)
<b><i>Total R&amp;D</i></b>	<b>\$9,294</b>	<b>\$9,625</b>	<b>(3</b>	<b>%)</b>
<b><i>Selling, General and Administrative:</i></b>				
<i>Apio</i>	\$21,976	\$14,776	49	%)
<i>Lifecore</i>	4,595	4,521	2	%)
<i>Corporate</i>	5,960	7,218	(17	%)
<b><i>Total S,G&amp;A</i></b>	<b>\$32,531</b>	<b>\$26,515</b>	<b>23</b>	<b>%)</b>
<b><i>Other operating expenses:</i></b>				
<i>Apio</i>	\$(3,933)	\$871	N/M	
<i>Corporate</i>	—	550	N/M	
<b><i>Total Other Operating Expenses</i></b>	<b>\$(3,933)</b>	<b>\$1,421</b>	<b>N/M</b>	

*Research and Development*

Landec's research and development consisted primarily of product development and commercialization initiatives. Research and development efforts at Apio are focused on the Company's proprietary BreatheWay membranes used for packaging produce, with a focus on extending the shelf-life of sensitive vegetables and fruit. In the Lifecore business,

the research and development efforts are focused on new products and applications for HA-based biomaterials. For Corporate, the research and development efforts are focused on supporting the development and commercialization of new products and new technologies in our food and HA businesses along with developing uses for our proprietary Intelimer polymers outside of our food and HA businesses.

The decrease in research and development expenses for fiscal year 2013 compared to the same period last year was primarily due to the decrease in research and development expenses incurred by Corporate during fiscal year 2012 at the Company's former seed corn business which was sold in June 2012.

*Selling, General and Administrative (S,G&A)*

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 S,G&A expenses for fiscal year 2013 compared to the same period last year was primarily due to: (1) a \$4.6 million increase in S,G&A expenses at Apio from GreenLine which was acquired on April 23, 2012 and (2) a \$2.6 million increase in SG&A at Apio, excluding GreenLine, due to the amortization of the customer base intangible acquired in the acquisition of GreenLine and additional sales and marketing expenses associated with the increase in revenues. These increases were partially offset by a \$1.3 million decrease in S,G&A at Corporate due primarily to no Corporate bonuses being earned in fiscal year 2013 compared to \$1.0 million of Corporate bonuses earned in fiscal year 2012 and from S,G&A expenses at the Company's former seed corn business in fiscal year 2012 which was sold in June 2012.

*Other Operating Expenses*

Other operating expenses in fiscal year 2013 consisted of a \$3.9 million reversal of the earn-out liability at Apio associated with the GreenLine acquisition. Other operating expenses in fiscal year 2012 consisted of expenses incurred as a result of the acquisition of GreenLine.

**Non-operating income/(expense)** (in thousands):

	<b>Fiscal Year ended</b>	<b>Fiscal Year ended</b>	<i>Change</i>	
	<b>May 26, 2013</b>	<b>May 27, 2012</b>		
<i>Dividend Income</i>	\$1,125	\$1,125	—	
<i>Interest Income</i>	\$179	\$180	(1	%)
<i>Interest Expense</i>	\$(2,008)	\$(929 )	116	%
<i>Other Income</i>	\$8,100	\$5,331	52	%
<i>Income Taxes</i>	\$(9,452)	\$(7,185)	32	%
<i>Non controlling Interest</i>	\$(225 )	\$(403 )	(44	%)

*Dividend Income*

Dividend income is derived from the dividends accrued on our \$15 million preferred stock investment in Windset which yields a cash dividend of 7.5% annually. There was no change in dividend income in fiscal year 2013 compared to fiscal year 2012.

*Interest Income*

The decrease in interest income for the fiscal year ended May 26, 2013 compared to the same period last year was primarily due to lower cash balances reflecting our use of cash to buyback shares of the Company's common stock

during fiscal year 2012 and to purchase GreenLine.

*Interest Expense*

The increase in interest expense during fiscal year 2013 compared to the same period last year was due to interest on the \$32 million of debt incurred in the acquisition of GreenLine. This increase was partially offset by decreases in interest expense at Lifecore due to paying down its debt by \$3.3 million during fiscal year 2013.

*Other Income*

The increase in other income for fiscal year 2013 compared to the same period last year is primarily due to the change in the fair market value of our Windset investment being \$2.3 million higher in fiscal year 2013 compared to the change in fiscal year 2012.

*Income Taxes*

The increase in the income tax expense for fiscal year 2013 is due to a 59% increase in net income before taxes compared to the same period last year. The effective tax rate for fiscal year 2013 was 30% compared to 36% for the same period last year primarily because the \$3.9 million reversal of the earn-out liability during fiscal year 2013 related to the GreenLine acquisition was not subject to income taxes and various to other tax deductions and credits in fiscal year 2013, such as the return of the R&D credit and the change in the Company's state apportionment factors due to the addition of GreenLine, which resulted in a lower effective tax rate for fiscal year 2013.

### *Non-controlling Interest*

The non-controlling interest consists of the limited partners' equity interest in the net income of Apio Cooling, LP.

The decrease in non-controlling interest for fiscal year 2013 compared to the same period last year was due to a decrease in Apio Cooling revenues.

### **Liquidity and Capital Resources**

As of May 25, 2014, the Company had cash and cash equivalents of \$14.2 million, a net increase of \$525,000 from \$13.7 million at May 26, 2013.

### *Cash Flow from Operating Activities*

Landec generated \$21.0 million of cash from operating activities during fiscal year 2014 compared to generating \$21.2 million from operating activities during fiscal year 2013. The primary sources of cash from operating activities during fiscal year 2014 were from (1) \$19.3 million of net income, (2) \$8.5 million of depreciation/amortization and stock-based compensation expenses and (3) a \$5.6 million net increase in deferred tax liabilities. The primary uses of cash from operating activities were from the \$10.0 million non-cash increase in the Company's investment in Windset and a net increase of \$2.7 million in working capital, excluding the portion of the increase in income taxes receivable which is attributable to the tax benefit from stock-based compensation.

The primary factors which increased working capital during fiscal year 2014 were a \$8.0 million increase in receivables primarily due to May 2014 revenues for Apio and Lifecore being \$5.3 million and \$1.7 million higher, respectively, than Apio's and Lifecore's May 2013 revenues. These increases in working capital were partially offset by a \$3.1 million increase in income taxes receivable due to overpayments and a \$3.2 million increase in current liabilities resulting primarily from the timing of invoices at Apio.

### *Cash Flow from Investing Activities*



Net cash used in investing activities for fiscal year 2014 was \$13.3 million compared to \$10.4 million for the same period last year. The primary uses of cash in investing activities during fiscal year 2014 were for the purchase of \$14.9 million of equipment primarily to support the growth of the Apio value-added and Lifecore businesses.

*Cash Flow from Financing Activities*

Net cash used in financing activities for fiscal year 2014 was \$7.2 million compared to \$19.3 million for the same period last year. The net cash used in financing activities during fiscal year 2014 was primarily due to the \$9.9 million of net payments on the Company's lines of credit and long-term debt offset by \$2.3 million received from proceeds from the sale of Common Stock. The primary use of cash from financing activities during fiscal year 2013 was from a \$10 million earn out payment made related to the Lifecore acquisition, \$9.7 million of which was recorded as a contingent liability at the time of the acquisition and was therefore classified as a financing activity.

*Capital Expenditures*

During the fiscal year ended May 25, 2014, Landec continued its expansion of Apio's value-added processing facility and purchased vegetable processing equipment as well as made facility modifications and equipment purchases at Lifecore to support business growth. These expenditures represented the majority of the \$14.9 million of capital expenditures during fiscal year 2014.

*Debt*

On August 19, 2004, Lifecore issued variable rate industrial revenue bonds (“IRBs”). These IRBs were assumed by Landec in the acquisition of Lifecore (see Note 9 to the Consolidated Financial Statements). The IRBs are collateralized by a bank letter of credit which is secured by a first mortgage on Lifecore’s facility in Chaska, Minnesota. In addition, Lifecore pays an annual remarketing fee equal to 0.125% and an annual letter of credit fee of 0.75%.

On April 23, 2012 in connection with the acquisition of GreenLine, Apio entered into three loan agreements with General Electric Capital Corporation and/or its affiliates (“GE Capital”), (collectively the “GE Debt Agreements”):

- 1) A five-year, \$25.0 million asset-based working capital revolving line of credit, with an interest rate of LIBOR plus 2%, with availability based on the combination of the eligible accounts receivable and inventory balances of Apio and its subsidiaries (availability was \$19.8 million at May 25, 2014). Apio’s revolving line of credit has an unused fee of 0.375% per annum. At May 25, 2014 and May 26, 2013, Apio had zero and \$4.0 million, respectively, outstanding under its revolving line of credit.
- 2) A \$12.7 million capital equipment loan which matures in seven years payable in monthly principal and interest payments of \$175,356 with interest based on a fixed rate of 4.39% per annum.
- 3) A \$19.2 million real estate loan, \$1.2 million of which was paid in April 2013, and the remainder maturing in ten years. The real estate loan has a fifteen year amortization period due in monthly principal and interest payments of \$141,962 with interest based on a fixed rate of 4.02% per annum. The principal balance remaining at the end of the ten year term is due in one lump sum on April 23, 2022.

Apio’s obligations under the GE Debt Agreements are secured by liens on all of the property of Apio and its subsidiaries. The GE Debt Agreements contain customary events of default under which obligations could be accelerated or increased. The GE Capital real estate and equipment loans are guaranteed by Landec, and Landec has pledged its equity interest in Apio as collateral under the line of credit agreement. The GE Debt Agreements contain customary covenants, such as limitations on the ability to (1) incur indebtedness or grant liens or negative pledges on Apio’s assets; (2) make loans or other investments; (3) pay dividends, sell stock or repurchase stock or other securities; (4) sell assets; (5) engage in mergers; (6) enter into sale and leaseback transactions; and (7) make changes in Apio’s corporate structure. In addition, Apio must maintain a minimum fixed charge coverage ratio of 1.10 to 1.0 if the availability under its line of credit falls below \$7.5 million. Apio was in compliance with all financial covenants as of May 25, 2014 and May 26, 2013. Unamortized loan origination fees for the GE Debt Agreements were \$964,000 and \$1.2 million at May 25, 2014 and May 26, 2013, respectively, and are included in other assets in the Consolidated Balance Sheets.

On May 23, 2012, Lifecore entered into two financing agreements with BMO Harris Bank N.A. and/or its affiliates (“BMO Harris”), collectively (the “Lifecore Loan Agreements”):

(1) A Credit and Security Agreement (the “Credit Agreement”) which includes (a) a two-year, \$10.0 million asset-based working capital revolving line of credit, with an interest rate of LIBOR plus 1.85%, with availability based on the combination of Lifecore’s eligible accounts receivable and inventory balances (availability was \$7.9 million at May 25, 2014) and with no unused fee (as of May 25, 2014 and May 26, 2013, no amounts were outstanding under the line of credit) and (b) a \$12.0 million term loan which matures in four years due in monthly payments of \$250,000 with interest payable monthly based on a variable interest rate of LIBOR plus 2% (the “Term Loan”).

(2) A Reimbursement Agreement pursuant to which BMO Harris caused its affiliate Bank of Montreal to issue an irrevocable letter of credit in the amount of \$3.5 million (the “Letter of Credit”) which is securing the IRBs described above.

The obligations of Lifecore under the Lifecore Loan Agreements are secured by liens on all of the property of Lifecore. The Lifecore Loan Agreements contain customary covenants, such as limitations on the ability to (1) incur indebtedness or grant liens or negative pledges on Lifecore's assets; (2) make loans or other investments; (3) pay dividends or repurchase stock or other securities; (4) sell assets; (5) engage in mergers; (6) enter into sale and leaseback transactions; (7) adopt certain benefit plans; and (8) make changes in Lifecore's corporate structure. In addition, under the Credit Agreement, Lifecore must maintain (a) a minimum fixed charge coverage ratio of 1.10 to 1.0 and a minimum quick ratio of 1.25 to 1.00, both of which must be satisfied as of the end of each fiscal quarter commencing with the fiscal quarter ending August 26, 2012 and (b) a minimum tangible net worth of \$29,000,000, measured as of May 28, 2013, and as of the end of each fiscal year thereafter. Unamortized loan origination fees for the Lifecore Loan Agreements were \$98,000 and \$149,000 at May 25, 2014 and May 26, 2013, respectively, and are included in other assets in the Consolidated Balance Sheets. Lifecore was in compliance with all financial covenants as of May 25, 2014 and May 26, 2013.

The market value of the Company's debt approximates its recorded value as the interest rates on each debt instrument approximates current market rates.

The Term Loan was used to repay Lifecore's former credit facility with Wells Fargo Bank, N.A. ("Wells Fargo"). The Letter of Credit (which replaces a letter of credit previously provided by Wells Fargo) provides liquidity and credit support for the IRBs.

In May 2010, the Company entered into a five-year interest rate swap agreement under the prior credit agreement with Wells Fargo, which expires on April 30, 2015. The interest rate swap was designated as a cash flow hedge of future interest payments of LIBOR and had 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 the credit agreement with Wells Fargo. The Company's obligations under the interest rate swap transaction as to the scheduled payments were guaranteed and secured on the same basis as its obligations under the credit agreement with Wells Fargo at the time the agreement was consummated. Upon entering into the new Term Loan with BMO Harris, the Company used the proceeds from that loan to pay off the Wells Fargo credit facility. The swap with Wells Fargo was not terminated upon the extinguishment of the debt with Wells Fargo. As a result of extinguishing the debt with Wells Fargo as of May 23, 2012, the swap was no longer an effective hedge and therefore, the fair value of the swap at the time the debt was extinguished of \$347,000 was reversed from other comprehensive income and recorded in other expense during fiscal year 2012. The fair value of the swap arrangement as of May 25, 2014 and May 26, 2013 was \$44,000 and \$163,000, respectively, and is included in other accrued liabilities in the accompanying Consolidated Balance Sheets.

#### *Contractual Obligations*

The Company's material contractual obligations for the next five years and thereafter as of May 25, 2014, are as follows (in thousands):

Due in Fiscal Year Ended May

Obligation	Total	2015	2016	2017	2018	2019	Thereafter
Income taxes	\$—	\$—	\$—	\$—	\$—	\$—	\$—
Debt principal payments	34,372	6,055	6,181	3,318	3,456	3,599	11,763
Interest payments	5,198	1,146	958	795	663	525	1,111
Operating leases	11,038	2,916	2,720	2,225	1,375	929	873
Purchase commitments	5,046	5,046	—	—	—	—	—
Total	\$55,654	\$15,163	\$9,859	\$6,338	\$5,494	\$5,053	\$ 13,747

The income tax amounts above exclude liabilities associated with the accounting for uncertainty in income taxes as we are unable to reasonably estimate the ultimate amount or timing of settlement. See Note 11 in the Notes to Consolidated Financial Statements for further discussion.

The interest payment amounts above include: (1) the 4.39% fixed interest rate payments on the GE Capital equipment loan, (2) the 4.02% fixed interest rate payments on the GE Capital real estate loan, (3) the estimated interest rate payment on the variable Term Loan with BMO Harris based on the four year historical average 30-day LIBOR plus 2% or 2.22% and (4) the estimated interest rate payment on the variable rate IRB based on the five year historical interest rate average for the Municipal Swap Index plus 20 basis points plus the letter of credit and remarketing fees of 0.875% resulting in a estimated rate of 1.25%.

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.

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 cash from operations, along with existing cash, cash equivalents and marketable securities will be sufficient to finance its operational and capital requirements for at least the next twelve months.

**Item 7A. *Quantitative and Qualitative Disclosures about Market Risk***

Not significant.

**Item 8. *Financial Statements and Supplementary Data***

See Item 15 of Part IV of this report.

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable.

**Item 9A. *Controls and Procedures***

***Evaluation of Disclosure Controls and Procedures***

As of May 25, 2014 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 Annual Report on Form 10-K. 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 Securities Exchange Act of 1934, as amended, 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.

***Management's Report on Internal Control over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management assessed the effectiveness of our internal control over financial reporting as of May 25, 2014. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control - Integrated Framework (1992 Framework). Our management has concluded that, as of May 25, 2014, our internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Our independent registered public accounting firm, Ernst & Young LLP, has issued an audit report on our internal control over financial reporting, which is included herein.

***Changes in Internal Controls over Financial Reporting***

There were no changes in our internal controls over financial reporting during the fiscal year ended May 25, 2014 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.



## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of Landec Corporation

We have audited Landec Corporation and subsidiaries' internal control over financial reporting as of May 25, 2014, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 Framework) (the COSO criteria). Landec Corporation and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Landec Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of May 25, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Landec Corporation and subsidiaries as of May 25, 2014 and May 26, 2013, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended May 25, 2014 and our report dated August 1, 2014 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Francisco, California

August 1, 2014

**Item 9B. *Other Information***

None

## **PART III**

### **Item 10. *Directors, Executive Officers and Corporate Governance***

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2014 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

### **Item 11. *Executive Compensation***

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2014 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

### **Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2014 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

### **Item 13. *Certain Relationships and Related Transactions and Director Independence***

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2014 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

### **Item 14. *Principal Accountant Fees and Services***

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2014 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

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**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a) 1. Consolidated Financial Statements of Landec Corporation

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Report of Independent Registered Public Accounting Firm	47
Consolidated Balance Sheets at May 25, 2014 and May 26, 2013	48
Consolidated Statements of Comprehensive Income for the Years Ended May 25, 2014, May 26, 2013 and May 27, 2012	49
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended May 25, 2014, May 26, 2013 and May 27, 2012	50
Consolidated Statements of Cash Flows for the Years Ended May 25, 2014, May 26, 2013 and May 27, 2012	51
Notes to Consolidated Financial Statements	52

2. All schedules provided for in the applicable accounting regulations of the Securities and Exchange Commission have been omitted since they pertain to items which do not appear in the financial statements of Landec Corporation and its subsidiaries or to items which are not significant or to items as to which the required disclosures have been made elsewhere in the financial statements and supplementary notes and such schedules.

3. Index of Exhibits..... 81

The exhibits listed in the accompanying Index of Exhibits are filed or incorporated by reference as part of this report.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of Landec Corporation

We have audited the accompanying consolidated balance sheets of Landec Corporation and subsidiaries as of May 25, 2014 and May 26, 2013, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended May 25, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Landec Corporation and subsidiaries at May 25, 2014 and May 26, 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended May 25, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Landec Corporation's internal control over financial reporting as of May 25, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 Framework) and our report dated August 1, 2014 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Francisco, California

August 1, 2014

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**LANDEC CORPORATION****CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share amounts)**

<b>ASSETS</b>	<b>May 25, 2014</b>	<b>May 26, 2013</b>
Current assets:		
Cash and cash equivalents	\$14,243	\$13,718
Marketable securities	—	1,545
Accounts receivable, less allowance for doubtful accounts of \$516 and \$583 at May 25, 2014 and May 26, 2013, respectively	44,421	36,427
Accounts receivable, related party	304	316
Income taxes receivable	2,000	5,103
Inventories, net	24,735	24,113
Deferred taxes	2,056	1,582
Prepaid expenses and other current assets	3,170	2,856
Total current assets	90,929	85,660
Investment in non-public company, non-fair value	793	793
Investment in non-public company, fair value	39,600	29,600
Property and equipment, net	74,140	65,811
Goodwill, net	49,620	49,620
Trademarks/ trade names, net	48,428	48,428
Customer relationships, net	8,720	9,606
Other assets	1,393	1,424
Total Assets	\$313,623	\$290,942
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$31,981	\$32,031
Accounts payable, related party	134	225
Accrued compensation	4,096	4,984
Other accrued liabilities	4,871	2,332
Deferred revenue	1,254	1,248
Lines of credit	—	4,000
Current portion of long-term debt	6,055	5,933
Total current liabilities	48,391	50,753
Long-term debt	28,317	34,372
Deferred taxes	30,133	24,054
Other non-current liabilities	2,021	1,349
Total liabilities	108,862	110,528
Commitments and contingencies (Note 12)		



Stockholders' equity:		
Common stock, \$0.001 par value; 50,000,000 shares authorized; 26,815,253 and 26,402,247 shares issued and outstanding at May 25, 2014 and May 26, 2013, respectively	27	26
Additional paid-in capital	131,488	126,258
Retained earnings	71,554	52,409
Total stockholders' equity	203,069	178,693
Non-controlling interest	1,692	1,721
Total Equity	204,761	180,414
Total Liabilities and Stockholders' Equity	\$313,623	\$290,942

*See accompanying notes.*

**LANDEC CORPORATION****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in thousands, except per share amounts)

	<b>Year Ended</b>	<b>Year Ended</b>	<b>Year Ended</b>
	<b>May 25, 2014</b>	<b>May 26, 2013</b>	<b>May 27, 2012</b>
Product sales	476,813	441,708	317,552
Cost of product sales	414,249	378,948	265,414
Gross profit	62,564	62,760	52,138
Operating costs and expenses:			
Research and development	7,204	9,294	9,625
Selling, general and administrative	35,170	32,531	26,515
Other operating expenses	—	(3,933 )	1,421
Total operating costs and expenses	42,374	37,892	37,561
Operating income	20,190	24,868	14,577
Dividend income	1,125	1,125	1,125
Interest income	260	179	180
Interest expense	(1,650 )	(2,008 )	(929 )
Other income	10,000	8,100	5,331
Net income before taxes	29,925	32,264	20,284
Income tax expense	(10,583 )	(9,452 )	(7,185 )
Consolidated net income	19,342	22,812	13,099
Non-controlling interest	(197 )	(225 )	(403 )
Net income and comprehensive income applicable to common stockholders	\$19,145	\$22,587	\$12,696
Basic net income per share	\$0.72	\$0.87	\$0.49
Diluted net income per share	\$0.71	\$0.85	\$0.49
Shares used in per share computation:			
Basic	26,628	25,830	25,849
Diluted	27,120	26,626	26,126

*See accompanying notes.*

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## LANDEC CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN

## STOCKHOLDERS' EQUITY

(in thousands, except share and per share amounts)

	Common Stock Shares	Additional Paid-in Capital	Retained Earnings	Other Comprehensive Loss	Total Stockholders' Equity	Non- controlling interest	
Balance at May 29, 2011	26,405,799	\$ 27	\$ 119,169	\$ 17,126	\$ (267 )	\$ 136,055	\$ 1,671
Issuance of common stock at \$2.55 to \$6.95 per share, net of taxes paid by Landec on behalf of employees	72,572	—	61	—	—	61	—
Issuance of common stock for vested restricted stock units	83,453	—	—	—	—	—	—
Common stock repurchased on the open market	(917,244 )	(1 )	(5,005 )	—	—	(5,006 )	—
Taxes paid by Company for stock swaps and RSUs	—	—	(260 )	—	—	(260 )	—
Stock-based compensation	—	—	1,872	—	—	1,872	—
Tax benefit from stock-based compensation expense	—	—	4,057	—	—	4,057	—
Non-controlling interest	—	—	—	—	—	—	403
Payments to non-controlling interest	—	—	—	—	—	—	(258 )
Net and comprehensive income	—	—	—	12,696	267	12,963	—
Balance at May 27, 2012	25,644,580	26	119,894	29,822	—	149,742	1,816
Issuance of common stock at \$1.66 to \$13.32 per share, net of taxes paid by Landec on behalf of employees	597,537	—	3,416	—	—	3,416	—
Issuance of common stock for vested restricted stock units	160,130	—	—	—	—	—	—
Taxes paid by Company for stock swaps and RSUs	—	—	(49 )	—	—	(49 )	—
Stock-based compensation	—	—	1,695	—	—	1,695	—
Tax benefit from stock-based compensation expense	—	—	1,302	—	—	1,302	—
Non-controlling interest	—	—	—	—	—	—	225
Payments to non-controlling interest	—	—	—	—	—	—	(320 )
Net and comprehensive income	—	—	—	22,587	—	22,587	—

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Balance at May 26, 2013	26,402,247	26	126,258	52,409	—	178,693	1,721
Issuance of common stock at \$5.63 to \$13.32 per share, net of taxes paid by Landec on behalf of employees	372,852	1	2,297	—	—	2,298	—
Issuance of common stock for vested restricted stock units	40,154	—	—	—	—	—	—
Taxes paid by Company for stock swaps and RSUs	—	—	(345 )	—	—	(345 )	—
Stock-based compensation	—	—	1,356	—	—	1,356	—
Tax benefit from stock-based compensation expense	—	—	1,922	—	—	1,922	—
Non-controlling interest	—	—	—	—	—	—	197
Payments to non-controlling interest	—	—	—	—	—	—	(226 )
Net and comprehensive income	—	—	—	19,145	—	19,145	—
Balance at May 25, 2014	26,815,253	\$ 27	\$ 131,488	\$ 71,554	\$ —	\$ 203,069	\$ 1,692

*See accompanying notes*

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

	<b>Year Ended</b>	<b>Year Ended</b>	<b>Year Ended</b>
	<b>May 25,</b>	<b>May 26,</b>	<b>May 27,</b>
	<b>2014</b>	<b>2013</b>	<b>2012</b>
Cash flows from operating activities:			
Consolidated net income	\$ 19,342	\$ 22,812	\$ 13,099
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	7,114	7,295	5,621
Stock-based compensation expense	1,356	1,695	1,872
Deferred taxes	5,605	6,511	3,283
Change in investment in non-public company , fair value	(10,000)	( 8,100 )	(5,838 )
Tax benefit from stock based compensation	(1,922 )	(1,302 )	(4,057 )
Net loss on disposal of property and equipment	329	217	12
Earn out liability	—	(3,933 )	—
Changes in assets and liabilities, net of effects from acquisitions:			
Accounts receivable, net	(7,994 )	(4,121 )	(3,246 )
Accounts receivable, related party	12	(348 )	130
Income taxes receivable	5,025	(3,754 )	4,581
Inventories, net	(622 )	(2,102 )	(441 )
Issuance of notes and advances receivable	(4,763 )	(4,173 )	(3,699 )
Collection of notes and advances receivable	4,481	4,173	3,704
Prepaid expenses and other current assets	(32 )	(278 )	3,588
Accounts payable	(50 )	8,826	(544 )
Accounts payable, related party	(91 )	10	476
Accrued compensation	38	(798 )	2,701
Other accrued liabilities	3,211	(2,486 )	3,434
Deferred revenue	6	1,086	(2,495 )
Net cash provided by operating activities	21,045	21,230	22,181
Cash flows from investing activities:			
Purchases of property and equipment	(14,886)	(8,877 )	(5,371 )
Acquisition of GreenLine (Note 2)	—	—	(66,826)
Purchase of marketable securities	(1,417 )	(4,959 )	(30,723)
Proceeds from maturities of marketable securities	2,962	3,414	31,104
Proceeds from sales of marketable securities	—	—	27,743
Net cash used in investing activities	(13,341)	(10,422)	(44,073)
Cash flows from financing activities:			
Repurchase of outstanding common stock	—	—	(5,006 )

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Proceeds from sale of common stock	2,298	3,416	61
Taxes paid by Company for stock swaps and RSUs	(1,271 )	(49 )	(260 )
Tax benefit from stock-based compensation expense	1,922	1,302	4,057
Earn out payment from Lifecore acquisition	—	(9,650 )	—
Net change in other assets/liabilities	31	712	(1,813 )
Proceeds from long term debt	—	—	31,816
Proceeds from lines of credit	9,500	—	12,766
Payments on long term debt	(5,933 )	(7,012 )	(4,329 )
Payments on lines of credit	(13,500)	(7,666 )	(1,100 )
Payments to non-controlling interest.	(226 )	(320 )	(258 )
Net cash (used in) provided by financing activities	(7,179 )	(19,267)	35,934
Net increase (decrease) in cash and cash equivalents	525		