

LANDEC CORP \CA\  
Form 10-Q  
April 09, 2008

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 10-Q**

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

**For the Fiscal Quarter Ended February 24, 2008, or**

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

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

Commission file number: **0-27446**

**LANDEC CORPORATION**

(Exact name of registrant as specified in its charter)

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

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

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

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

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

Yes  No

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

Large Accelerated Filer  Accelerated Filer   
Non Accelerated Filer  Smaller Reporting Company

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

Yes  No

As of March 21, 2008, there were 26,153,318 shares of Common Stock outstanding.

**LANDEC CORPORATION**

FORM 10-Q For the Fiscal Quarter Ended February 24, 2008

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

**LANDEC CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands)

	February 24, 2008 (Unaudited)	May 27, 2007
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 55,265	\$ 62,556
Accounts receivable, less allowance for doubtful accounts of \$173 and \$206 at February 24, 2008 and May 27, 2007	14,908	17,631
Accounts receivable, related party	368	554
Inventories, net	6,314	6,800
Notes and advances receivable	676	282
Prepaid expenses and other current assets	1,714	1,316
<b>Total Current Assets</b>	<b>79,245</b>	<b>89,139</b>
Property, plant and equipment, net	20,361	20,270
Goodwill, net	22,566	21,402
Trademarks, net	8,228	8,228
Notes receivable	—	96
Other assets	2,838	2,233
<b>Total Assets</b>	<b>\$ 133,238</b>	<b>\$ 141,368</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 11,578	\$ 13,705
Related party accounts payable	46	175
Income taxes payable	612	458
Accrued compensation	1,760	3,126
Other accrued liabilities	1,657	1,340
Related party note payable	86	—
Deferred revenue	4,119	3,491
<b>Total Current Liabilities</b>	<b>19,858</b>	<b>22,295</b>
Related party note payable	76	—
Deferred revenue	5,500	7,000
Minority interest	1,423	1,845
<b>Total Liabilities</b>	<b>26,857</b>	<b>31,140</b>
Shareholders' Equity:		
Common stock and additional paid in capital, \$0.001 par value; 50,000,000 shares authorized; 26,153,318 and 25,891,168 shares issued and outstanding at February 24, 2008 and May 27, 2007, respectively	131,368	129,560
Accumulated deficit	(24,987)	(19,332)

Total Shareholders' Equity		106,381		110,228
Total Liabilities and Shareholders' Equity	\$	133,238	\$	141,368

*See accompanying notes.*

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

	Three Months Ended		Nine Months Ended	
	February 24, 2008	February 25, 2007	February 24, 2008	February 25, 2007
<b>Revenues:</b>				
Product sales	\$ 56,907	\$ 50,148	\$ 172,981	\$ 153,779
Services revenue, related party	737	826	2,721	2,500
License fees	1,720	1,550	4,851	2,431
Research, development and royalty revenues	243	69	642	190
Royalty revenues, related party	—	362	32	397
<b>Total revenues</b>	<b>59,607</b>	<b>52,955</b>	<b>181,227</b>	<b>159,297</b>
<b>Cost of revenue:</b>				
Cost of product sales	48,087	43,017	148,457	131,862
Cost of product sales, related party	150	200	1,932	2,422
Cost of services revenue	623	648	2,261	2,090
<b>Total cost of revenue</b>	<b>48,860</b>	<b>43,865</b>	<b>152,650</b>	<b>136,374</b>
<b>Gross profit</b>	<b>10,747</b>	<b>9,090</b>	<b>28,577</b>	<b>22,923</b>
<b>Operating costs and expenses:</b>				
Research and development	802	663	2,411	2,287
Selling, general and administrative	4,823	4,839	13,608	17,030
Income from sale of FCD	—	(22,690)	—	(22,690)
<b>Total operating costs and expenses</b>	<b>5,625</b>	<b>(17,188)</b>	<b>16,019</b>	<b>(3,373)</b>
<b>Operating income</b>	<b>5,122</b>	<b>26,278</b>	<b>12,558</b>	<b>26,296</b>
Interest income	527	662	1,915	1,075
Interest expense	(5)	(57)	(18)	(248)
Minority interest	(121)	(137)	(350)	(252)
Other expense	(37)	—	(37)	(2)
<b>Net income before taxes</b>	<b>5,486</b>	<b>26,746</b>	<b>14,068</b>	<b>26,869</b>
Income tax expense	(1,520)	(2,101)	(3,900)	(2,101)
<b>Net Income</b>	<b>\$ 3,966</b>	<b>\$ 24,645</b>	<b>\$ 10,168</b>	<b>\$ 24,768</b>
Basic net income per share	\$ 0.15	\$ 0.97	\$ 0.39	\$ 0.99
Diluted net income per share	\$ 0.15	\$ 0.92	\$ 0.38	\$ 0.92
<b>Shares used in per share computation:</b>				
Basic	26,109	25,317	26,039	25,098
Diluted	26,936	26,627	26,961	26,433

*See accompanying notes.*





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

	Nine Months Ended	
	February 24, 2008	February 25, 2007
Cash flows from operating activities:		
Net income	\$ 10,168	\$ 24,768
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,273	2,542
Income tax expense not payable	3,675	—
Stock-based compensation expense	688	504
Minority interest	350	252
Increase in long-term receivable	(600)	(200)
Income from sale of FCD	—	(24,608)
Loss on sale of property and equipment	—	38
Investment in unconsolidated business	—	(481)
Changes in current assets and current liabilities:		
Accounts receivable, net	2,723	972
Accounts receivable, related party	186	—
Inventories, net	486	(7,752)
Issuance of notes and advances receivable	(2,286)	(1,995)
Collection of notes and advances receivable	1,882	1,629
Prepaid expenses and other current assets	(398)	(597)
Accounts payable	(2,127)	(6,884)
Related party accounts payable	(129)	(415)
Income taxes payable	154	2,090
Accrued compensation	(1,366)	(111)
Other accrued liabilities	317	(578)
Deferred revenue	(872)	3,643
Net cash provided by (used in) operating activities	15,124	(7,183)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(2,364)	(5,953)
Issuance of notes and advances receivable	(10)	(29)
Collection of notes and advances receivable	116	262
Net proceeds from sale of FCD (Note 2)	—	49,462
Acquisition of business and earnout payments	(86)	(1,217)
Net cash (used in) provided by investing activities	(2,344)	42,525
Cash flows from financing activities:		
Proceeds from sale of common stock	1,120	2,672
Proceeds from the exercise of subsidiary options	—	10
Repurchase of subsidiary's common stock and options	(20,837)	(7,371)
(Increase) decrease in other assets	(5)	70
Payment on related party note payable (Note 11)	(66)	—
Borrowings on lines of credit	—	9,338
Payments on long term debt	—	(1,984)

Distributions to minority interest	(283)	(298)
Net cash (used in) provided by financing activities	(20,071)	2,437
Net (decrease) increase in cash and cash equivalents	(7,291)	37,779
Cash and cash equivalents at beginning of period	62,556	20,519
Cash and cash equivalents at end of period	\$ 55,265	\$ 58,298
Supplemental schedule of noncash operating activities:		
Preferred stock received from investment in unconsolidated business	\$ —	\$ 481

*See accompanying notes.*

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

**1. Basis of Presentation**

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

The accompanying unaudited consolidated financial statements of Landec have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made which are necessary to present fairly the financial position of the Company at February 24, 2008 and the results of operations and cash flows for all periods presented. Although Landec believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in financial statements and related footnotes prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted per the rules and regulations of the Securities and Exchange Commission. The accompanying financial data should be reviewed in conjunction with the audited financial statements and accompanying notes included in Landec's Annual Report on Form 10-K for the fiscal year ended May 27, 2007.

The results of operations for the three and nine months ended February 24, 2008 are not necessarily indicative of the results that may be expected for an entire fiscal year due to some seasonality in Apio's food business.

**Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported results of operations during the reporting period. Actual results could differ materially from those estimates.

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

**Investments**

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

**Recent Accounting Pronouncements**

In June 2006, FASB's EITF reached a consensus on Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement". EITF Issue 06-3 provides

accounting guidance regarding the presentation of taxes assessed by a governmental authority on a revenue producing transaction between a seller and a customer such as sales and use taxes. EITF Issue 06-3 was effective for fiscal years beginning after December 15, 2006. The adoption did not have a material effect on the Company's consolidated financial position or results of operations.

In July 2006, FASB issued FIN 48 “Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109” which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. FIN 48 requires that a company recognize the financial statement effects of a tax position when there is a likelihood of more than 50 percent, based on the technical merits, that the position will be sustained upon examination. It also provides guidance on the derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition requirements for uncertain tax positions. The accounting provisions of FIN 48 was effective for the Company beginning January 1, 2007. The adoption of FIN 48 did not have a material effect on the Company’s consolidated financial position or results of operations.

In September 2006, FASB issued SFAS No. 157, “Fair Value Measurements.” SFAS No. 157 defines fair value, establishes a frame work for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 does not require new fair value measurements but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of information. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. However, on February 12, 2008, the FASB issued FASB Staff (“FSP”) FAS No. 157-2 which delays the effective date for all non-financial assets and liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP 157- 2 defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within the fiscal years for items within the scope of this FSP. Effective for 2008, the Company will adopt SFAS No. 157, except as it applies to those non-financial assets and non-financial liabilities as noted in FSP FAS 157-2. The Company does not expect it to have a material effect on its consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities— Including an amendment of FASB Statement No. 115.” SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Subsequent measurements for the financial instruments and liabilities an entity elects to fair value will be recognized in earnings. SFAS No. 159 also establishes additional disclosure requirements. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted provided the entity also elects to apply the provisions of SFAS No. 157. The Company does not expect its adoption to have a material effect on its consolidated financial position or results of operations.

The FASB issued SFAS No. 141R (revised 2007), “Business Combinations.” which significantly changes the financial accounting and reporting of business combination transactions. SFAS No. 141R requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction and establishes the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of this standard will, among other things, impact the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration); exclude transaction costs from acquisition accounting; and change accounting practices for acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. For the Company, SFAS No. 141R is effective for business combinations occurring after December 31, 2008. The Company is currently evaluating the future impacts and disclosures of this standard.

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

period beginning on or after December 15, 2008. As of December 31, 2007 and 2006, the Company had no noncontrolling interests on its consolidated financial statements. The Company is currently evaluating the impact of this standard, but would not expect it to have a material impact on its consolidated financial statements.

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

### **Reclassifications**

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

### **2. License Agreement with Chiquita Brands International, Inc.**

On September 19, 2007, the Company amended its licensing and supply agreement with Chiquita Brands International, Inc. ("Chiquita"). Under the terms of the amendment, the license for bananas has been expanded to include additional exclusive fields using Landec's BreatheWay® packaging technology, and a new exclusive license has been added for the sale and marketing of avocados using Landec's BreatheWay packaging technology. In exchange for expanding the exclusive fields for bananas and adding a new exclusive field for avocados, the minimum gross profits to be received by Landec from the sale of BreatheWay packaging to Chiquita for bananas and avocados will increase to \$2.9 million in fiscal year 2008 (virtually all of which is being recognized during the second half of fiscal year 2008) and to \$2.2 million in fiscal year 2009. In addition, the minimum gross profits the Company is to receive are calculated and payable on a calendar quarter basis per the terms of the amended agreement. Accordingly, the minimum amounts under the amended agreement will be calculated each calendar quarter and thus will be due at the end of March, June, September and December of each year.

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

On December 1, 2006, Landec sold its direct marketing and sales seed company, Fielder's Choice Direct ("FCD"), which included the Fielder's Choice Direc® and Heartland Hybrid® brands, to American Seeds, Inc., a wholly owned subsidiary of Monsanto Company ("Monsanto"). The acquisition price for FCD was \$50 million in cash paid at the close. During fiscal year 2007, Landec recorded income from the sale, net of direct expenses and bonuses, of \$22.7 million. The income that was recorded is equal to the difference between the fair value of FCD of \$40 million and its net book value, less direct selling expenses and bonuses. In accordance with generally accepted accounting principles, the portion of the \$50 million of proceeds in excess of the fair value of FCD, or \$10 million, will be allocated to the technology license agreement described below and will be recognized as revenue ratably over the five year term of the technology license agreement or \$2 million per year beginning December 1, 2006. The fair value was determined by management.

On December 1, 2006, Landec also entered into a five-year co-exclusive technology license and polymer supply agreement (the "Agreement") with Monsanto for the use of Landec's Intellicoat polymer seed coating technology. Under the terms of the Agreement, Monsanto will pay Landec \$2.6 million per year in exchange for (1) a co-exclusive right to use Landec's Intellicoat temperature activated seed coating technology worldwide during the license period, (2) the right to be the exclusive global sales and marketing agent for the Intellicoat seed coating technology, and (3) the right

to purchase the technology any time during the five year term of the Agreement. Monsanto will also fund all operating costs, including all Intellicoat research and development, product development and non-replacement capital costs during the five year agreement period. For the three and nine months ended February 24, 2008, Landec recognized \$1.35 million and \$4.05 million, respectively, in revenues and operating income from the Agreement.

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The Agreement also provides for a fee payable to Landec of \$4 million if Monsanto elects to terminate the Agreement or \$8 million if Monsanto elects to purchase the technology. If the purchase option is exercised before the fifth anniversary of the Agreement, or if Monsanto elects to terminate the Agreement, all annual license fees and supply payments that have not been paid to Landec will become due upon the purchase or early termination. If Monsanto does not exercise its purchase option by the fifth anniversary of the Agreement, Landec will receive the termination fee and all rights to the Intellicoat seed coating technology will revert to Landec. Accordingly, Landec will receive minimum guaranteed payments of \$17 million, or \$3.4 million per year, for license fees and polymer supply payments over five years or \$21 million in maximum payments if Monsanto elects to purchase Landec Ag. If Monsanto exercises its purchase option, Landec and Monsanto will enter into a new long-term supply agreement in which Landec will continue to be the exclusive supplier of Intellicoat polymer materials to Monsanto.

Excluding the \$1.35 million in revenues and operating income from the Agreement for the three and nine months ended February 25, 2007, Landec Ag revenues for the three and nine months ended February 25, 2007 were \$0 and \$131,000, respectively and operating losses for the three and nine months ended February 25, 2007, were \$404,000 and \$5.8 million, respectively.

#### 4. Stock-Based Compensation

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard to (i) all stock-based awards issued on or after May 29, 2006 and (ii) any outstanding stock-based awards that were issued but not vested as of May 29, 2006. In the three and nine months ended February 24, 2008, the Company recognized stock-based compensation expense of \$182,000 and \$688,000 or \$0.01 and \$0.03 per basic and diluted share, respectively, which included \$81,000 and \$224,000 for restricted stock unit awards and \$101,000 and \$464,000 for stock option grants, respectively. In the three and nine months ended February 25, 2007, the Company recognized stock-based compensation expense of \$122,000 and \$504,000 or \$0.01 and \$0.02 per basic and diluted share, respectively, which included \$42,000 and \$117,000 for restricted stock unit awards and \$80,000 and \$387,000 for stock option grants, respectively.

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

	<b>Three Months Ended February 24, 2008</b>	<b>Three Months Ended February 25, 2007</b>	<b>Nine Months Ended February 24, 2008</b>	<b>Nine Months Ended February 25, 2007</b>
Research and development	\$ 39,000	\$ 20,000	\$ 109,000	\$ 62,000
Selling, general and administrative	\$ 143,000	\$ 102,000	\$ 579,000	\$ 442,000
Total stock-based compensation expense	\$ 182,000	\$ 122,000	\$ 688,000	\$ 504,000

As of February 24, 2008, there was \$1.0 million of total unrecognized compensation expense related to unvested equity compensation awards granted under the Company's incentive stock plans. Total expense is expected to be recognized over the weighted-average period of 1.35 years.

During the nine months ended February 24, 2008, the Company granted options to purchase 104,500 shares of common stock and 34,835 restricted stock unit awards.

As of February 24, 2008, the Company has reserved 2.5 million shares of common stock for future issuance under its current and former stock plans.

## 5. Income Taxes

The estimated annual effective tax rate for fiscal 2008 is currently expected to be approximately 28%. The primary difference between the estimated annual effective tax rate of 28% and the federal statutory tax rate relates to the projected elimination of the deferred income tax valuation allowance. The provision for income taxes for the three and nine months ended February 24, 2008 was approximately \$1.5 million and \$3.9 million, respectively.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("FAS 109"). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

The Company adopted FIN 48 effective May 28, 2007. As a result of the implementation of FIN 48, the Company did not recognize a cumulative adjustment to the May 28, 2007 balance of retained earnings as the amount was deemed immaterial.

As of May 28, 2007, the Company had unrecognized tax benefits of approximately \$277,000. Included in the balance of unrecognized tax benefits as of May 28, 2007 is approximately \$259,000 of tax benefits that, if recognized, would result in an adjustment to the Company's effective tax rate.

In accordance with FIN 48, paragraph 19, the Company has decided to classify interest and penalties related to uncertain tax positions as a component of its provision for income taxes. Due to the Company's historical taxable loss position, the Company did not accrue interest and penalties relating to the income tax on the unrecognized tax benefits as of May 27, 2007 and February 24, 2008 as the amounts were immaterial. Accordingly, the amount of interest and penalties included as a component of provision for income taxes in the three and nine months ended February 24, 2008 is immaterial.

Due to tax attribute carryforwards, the Company is subject to examination for tax years 1991 forward for U.S. tax purposes. The Company was also subject to examination in various state jurisdictions for tax years 1996 forward, none of which were individually material. The Company does not expect that the amounts of unrecognized tax benefits will change significantly within the next twelve months.

## 6. Net Income Per Diluted Share

The following table sets forth the computation of diluted net income for the periods with minority interest income of subsidiaries (see Note 8) (in thousands, except per share amounts):

	Three Months Ended February 24, 2008	Three Months Ended February 25, 2007	Nine Months Ended February 24, 2008	Nine Months Ended February 25, 2007
Numerator:				
Net income	\$ 3,966	\$ 24,645	\$ 10,168	\$ 24,768
Less: Minority interest in income of subsidiary	—	(235)	(23)	(575)
Net income for diluted net income per share	\$ 3,966	\$ 24,410	\$ 10,056	\$ 24,193
Denominator:				
Weighted average shares for basic net income per share	26,109	25,317	26,039	25,098
Effect of dilutive securities:				
Stock Options	827	1,310	922	1,335
Weighted average shares for diluted net income per share	26,936	26,627	26,961	26,433
Diluted net income per share	\$ 0.15	\$ 0.92	\$ 0.38	\$ 0.92

For the three months ended February 24, 2008 and February 25, 2007, the computation of the diluted net income per share excludes the impact of options to purchase 104,500 shares and 89,177 shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

For the nine months ended February 24, 2008 and February 25, 2007, the computation of the diluted net income per share excludes the impact of options to purchase 92,634 shares and 97,277 shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

## 7. Debt

Apio has a \$7.0 million revolving line of credit with Wells Fargo Bank N.A. ("Wells Fargo"). On September 1, 2007, Apio amended its revolving line of credit with Wells Fargo by extending the term of the line to August 31, 2009. In addition, the interest rate on the revolving line of credit was reduced to either prime less 0.75% or the LIBOR adjusted rate plus 1.50%. The revolving line of credit with Wells Fargo contains certain restrictive covenants, which require Apio to meet certain financial tests, including minimum levels of net income, maximum leverage ratio, minimum net worth and maximum capital expenditures. Landec has pledged substantially all of the assets of Apio to secure the line of credit with Wells Fargo. At February 24, 2008, no amounts were outstanding under the revolving line of credit. Apio has been in compliance with all loan covenants during the nine months ended February 24, 2008.

## 8. Repurchase of Subsidiary Common Stock and Options

On August 7, 2007, Landec repurchased all of the outstanding common stock and options of Apio not owned by Landec at the fair market value of each share as if all options had been exercised on that date. The fair market value repurchase price for all of Apio's common stock and options not owned by Landec was \$20.8 million. After the repurchase, Apio became a wholly owned subsidiary of Landec. In accordance with SFAS 123R, this repurchase did

not result in additional compensation expense to the Company as all of the common stock and options repurchased were fully vested at the time of the repurchase and the consideration paid was equal to the fair value. The repurchase of Apio options for \$19.7 million was recorded as a reduction to equity.

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## 9. Goodwill and Other Intangibles

The Company is required under SFAS 142 to review goodwill and indefinite lived intangible assets at least annually or when an event occurs or circumstances change such that it is reasonably possible that an impairment may exist. The Company completed its annual impairment review on July 1, 2007. The review consists of estimating the fair value of each reporting unit and comparing those estimated fair values with the carrying values of the reporting units, which includes the allocated goodwill. If the fair value is less than the carrying value the amount of impairment must be computed by determining an implied fair value of goodwill. The implied fair value of goodwill is the residual fair value derived by deducting the fair value of a reporting unit's assets and liabilities from its estimated fair value. The impairment charge represents the excess of the carrying amount of the reporting unit's goodwill over the implied fair value of its goodwill. The determination of fair value is based on estimated future discounted cash flows related to the reporting units. The discount rate used was based on the risks associated with the reporting units. The determination of fair value was performed by management. The review concluded that the fair value of the reporting units exceeded the carrying value of their net assets. As of February 24, 2008, no impairment charge was warranted. As a result of the repurchase of Apio's outstanding common stock (see Note 8), goodwill increased \$1.1 million during the first nine months of fiscal year 2008 in the Food Products Technology segment.

## 10. Inventories

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

	February 24, 2008	May 27, 2007
Raw materials	\$ 4,396	\$ 4,527
Finished goods	1,918	2,273
<b>Total</b>	<b>\$ 6,314</b>	<b>\$ 6,800</b>

## 11. Related Party

Apio provides cooling and distributing services for farms in which the Chairman of Apio (the "Apio Chairman") has a financial interest and purchases produce from those farms. Apio also purchases produce from Beachside Produce LLC for sale to third parties. Beachside Produce is owned by a group of entities and persons that supply produce to Apio. One of the owners of Beachside Produce is the Apio Chairman. Revenues and the resulting accounts receivable and cost of product sales and the resulting accounts payable are classified as related party items in the accompanying financial statements as of February 24, 2008 and May 27, 2007 and for the three and nine months ended February 24, 2008 and February 25, 2007.

Apio leases, for approximately \$300,000 on an annual basis, agricultural land that is owned by the Apio Chairman. Apio, in turn, subleases that land at cost to growers who are obligated to deliver product from that land to Apio for value added products. There is generally no net statement of operations impact to Apio as a result of these leasing activities but Apio creates a guaranteed source of supply for the value added business. Apio has loss exposure on the leasing activity to the extent that it is unable to sublease the land. For the three and nine months ended February 24, 2008 the Company subleased all of the land leased from the Apio Chairman and received sublease income of \$76,000 and \$265,000, respectively, which is equal to the amount the Company paid to lease that land for the period.

Apio's domestic commodity vegetable business was sold to Beachside Produce, effective June 30, 2003. The Apio Chairman is a 12.5% owner in Beachside Produce. During the three and nine months ended February 24, 2008, the Company recognized revenues of \$410,000 and \$1.2 million, respectively, from the sale of products to Beachside

Produce. For the nine months ended February 24, 2008, the Company recognized royalty revenue of \$32,000 from the use by Beachside Produce of Apio's trademarks. The related accounts receivable from Beachside Produce are classified as related party in the accompanying financial statements as of February 24, 2008 and May 27, 2007.

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At May 27, 2007, the Apio Chairman held a 6% ownership interest in Apio Cooling LP (“Apio Cooling”), a limited partnership in which Apio is the general partner and majority owner with a 60% ownership interest. During the first quarter of fiscal year 2008, the Apio Chairman withdrew from Apio Cooling. In accordance with the partnership agreement, the Apio Chairman’s minority interest will be paid in three annual installments with the first payment having been made in the second quarter of fiscal year 2008. The amounts due are classified as a related party note payable as of February 24, 2008 in the accompanying financial statements. As of May 27, 2007, the \$227,000 owed to the Apio Chairman was included in the minority interest liability as the Apio Chairman did not withdraw from Apio Cooling until the first quarter of fiscal year 2008.

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

## **12. Comprehensive Income (Loss)**

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

## **13. Shareholders’ Equity**

During the three and nine months ended February 24, 2008, 66,884 and 262,150 shares of Common Stock, respectively, were issued upon the vesting of RSUs and upon the exercise of options under the Company’s stock option plans. The Company received \$339,000 and \$1.1 million upon the exercise of options for the three and nine months ended February 24, 2008, respectively.

## **14. Business Segment Reporting**

Landec operates in two business segments: the Food Products Technology segment and the Technology Licensing segment. The Food Products Technology segment markets and packs specialty packaged whole and fresh-cut vegetables that incorporate the BreatheWay specialty packaging for the retail grocery, club store and food services industry. In addition, the Food Products Technology segment sells BreatheWay packaging to partners for non-vegetable products. The Technology Licensing segment licenses Landec’s patented Intellicoat seed coatings to the farming industry and licenses the Company’s Intelimer® polymers for personal care products and other industrial products. Corporate includes corporate general and administrative expenses, non Food Products Technology interest income and Company-wide income tax expenses. All of the assets of the Company are located within the United States of America. Prior to fiscal year 2008, Landec’s operating segments were Food Products Technology, which has not changed, and Agricultural Seed Technology. As a result of the sale of FCD to Monsanto (see Note 3), the Company has eliminated the Agricultural Seed Technology segment and has established the Technology Licensing segment. As a result, the segment information for the three and nine months ended February 25, 2007 has been reclassified to conform with the current year classification. Included in the Technology Licensing segment for the three and nine months ended February 25, 2007 are the results of Landec Ag which includes FCD. In addition, the licensing activity for non food and Ag collaborations is included in the Technology Licensing segment whereas in periods prior to fiscal year 2008 it was included in Corporate.

## Operations by Business Segment (in thousands):

Three months ended February 24, 2008	Food Products		Technology		Corporate	TOTAL
	Technology	Licensing	Licensing	Technology		
Net revenues	\$ 57,736	\$ 1,871	\$ —	\$ —	\$ —	\$ 59,607
International sales	\$ 8,945	\$ ¾	\$ ¾	\$ ¾	\$ ¾	\$ 8,945
Gross profit	\$ 8,876	\$ 1,871	\$ —	\$ —	\$ —	\$ 10,747
Net income (loss)	\$ 4,835	\$ 1,322	\$ (2,191)	\$ —	\$ —	\$ 3,966
Interest expense	\$ 5	\$ —	\$ ¾	\$ —	\$ ¾	\$ 5
Interest income	\$ 97	\$ —	\$ 430	\$ —	\$ —	\$ 527
Depreciation and amortization	\$ 754	\$ 51	\$ —	\$ —	\$ —	\$ 805
Income tax expense	\$ —	\$ —	\$ 1,520	\$ —	\$ —	\$ 1,520
Three months ended February 25, 2007						
Net revenues	\$ 51,343	\$ 1,612	\$ —	\$ —	\$ —	\$ 52,955
International sales	\$ 6,881	\$ ¾	\$ ¾	\$ ¾	\$ ¾	\$ 6,881
Gross profit	\$ 7,453	\$ 1,637	\$ —	\$ —	\$ —	\$ 9,090
Net income (loss)	\$ 4,006	\$ 23,544	\$ (2,905)	\$ —	\$ —	\$ 24,645
Interest expense	\$ 3	\$ 54	\$ ¾	\$ —	\$ ¾	\$ 57
Interest income	\$ 158	\$ —	\$ 504	\$ —	\$ —	\$ 662
Depreciation and amortization	\$ 696	\$ 80	\$ —	\$ —	\$ —	\$ 776
Income tax expense	\$ —	\$ —	\$ 2,101	\$ —	\$ —	\$ 2,101
Nine months ended February 24, 2008						
Net revenues	\$ 176,029	\$ 5,198	\$ —	\$ —	\$ —	\$ 181,227
International sales	\$ 45,476	\$ ¾	\$ ¾	\$ ¾	\$ ¾	\$ 45,476
Gross profit	\$ 23,379	\$ 5,198	\$ —	\$ —	\$ —	\$ 28,577
Net income (loss)	\$ 12,052	\$ 3,695	\$ (5,579)	\$ —	\$ —	\$ 10,168
Interest expense	\$ 18	\$ —	\$ ¾	\$ —	\$ ¾	\$ 18
Interest income	\$ 409	\$ —	\$ 1,506	\$ —	\$ —	\$ 1,915
Depreciation and amortization	\$ 2,108	\$ 165	\$ —	\$ —	\$ —	\$ 2,273
Income tax expense	\$ —	\$ —	\$ 3,900	\$ —	\$ —	\$ 3,900
Nine months ended February 25, 2007						
Net revenues	\$ 156,638	\$ 2,659	\$ —	\$ —	\$ —	\$ 159,297
International sales	\$ 38,655	\$ ¾	\$ ¾	\$ ¾	\$ ¾	\$ 38,655
Gross profit	\$ 20,448	\$ 2,475	\$ —	\$ —	\$ —	\$ 22,923
Net income (loss)	\$ 10,459	\$ 18,086	\$ (3,777)	\$ —	\$ —	\$ 24,768
Interest expense	\$ 77	\$ 171	\$ ¾	\$ —	\$ ¾	\$ 248
Interest income	\$ 503	\$ —	\$ 572	\$ —	\$ —	\$ 1,075
Depreciation and amortization	\$ 2,028	\$ 514	\$ —	\$ —	\$ —	\$ 2,542
Income tax expense	\$ —	\$ —	\$ 2,101	\$ —	\$ —	\$ 2,101

During the nine months ended February 24, 2008 and February 25, 2007, sales to the Company's top five customers accounted for approximately 47% and 50%, respectively, of revenues, with the Company's top customer from the Food Products Technology segment, Costco Wholesale Corp., accounting for approximately 19% and 20%, respectively, of total revenues. The Company expects that, for the foreseeable future, a limited number of customers may continue to account for a significant portion of its net revenues. The Company's international sales are primarily to Taiwan, Indonesia and Japan.





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

The following discussion should be read in conjunction with the unaudited consolidated financial statements and accompanying notes included in Part I--Item 1 of this Form 10-Q and the audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in Landec's Annual Report on Form 10-K for the fiscal year ended May 27, 2007.

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Potential risks and uncertainties include, without limitation, those mentioned in this report and, in particular the factors described below under "Additional Factors That May Affect Future Results," and those mentioned in Landec's Annual Report on Form 10-K for the fiscal year ended May 27, 2007. Landec undertakes no obligation to update or revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this report.

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

There have been no material changes to the Company's critical accounting policies which are included and described in the Form 10-K for the fiscal year ended May 27, 2007 filed with the Securities and Exchange Commission on July 27, 2007.

### **The Company**

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

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

Subsequent to the sale of Landec's former direct marketing and sales seed corn company, Fielder's Choice Direct, to Monsanto in fiscal year 2007, Landec now has two core businesses - Food Products Technology and Technology Licensing (see note 14).

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

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

Corporation (“Nitta”).

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

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## Description of Core Business

Landec participates in two core business segments- Food Products Technology and Technology Licensing.

### *Food Products Technology Business*

The Company began marketing in early 1996 our proprietary Intelimer-based specialty packaging for use in the fresh-cut produce market, one of the fastest growing segments in the produce industry. Our proprietary BreatheWay packaging technology, when combined with produce that is processed by washing, and in some cases cut and mixed, results in packaged produce with increased shelf life, reduced shrink (waste) and without the need for ice during the distribution cycle, which we refer to as our “value-added” products. In 1999, we acquired Apio, our largest customer at that time in the Food Products Technology business and one of the nation’s leading marketers and packers of produce and specialty packaged fresh-cut vegetables. Apio provides year-round access to produce, utilizes state-of-the-art fresh-cut produce processing technology and distributes products to the top U.S. retail grocery chains, major club stores and to the foodservice industry. The vertical integration of Landec’s BreatheWay technology and Apio’s packaging and sales capabilities within the Food Products Technology business gives Landec direct access to the large and growing fresh-cut produce market. The value-added business markets a variety of fresh-cut and whole vegetables to the top retail grocery chains and club stores. During the fiscal year ended May 27, 2007, Apio shipped more than seventeen million cartons of produce to leading supermarket retailers, wholesalers, foodservice suppliers and club stores throughout the United States and internationally, primarily in Asia.

There are 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 fresh-cut and whole value-added produce. It is focused on selling products under its Eat Smart® brand and other brands for its fresh-cut and whole value-added products. As retail grocery and club store chains consolidate, Apio is well positioned as a single source of a broad range of products.
- **Reduced Farming Risks:** Apio reduces its farming risk by not taking ownership of farmland, and instead, contracts with growers for produce. The year-round sourcing of produce is a key component to the fresh-cut and whole value-added processing business.
- **Lower Cost Structure:** Apio has strategically invested in the rapidly growing fresh-cut and whole value-added business. Apio’s 96,000 square foot value-added processing plant, which was expanded in fiscal year 2007 from 60,000 square feet, is automated with state-of-the-art vegetable processing equipment. Virtually all of Apio’s value-added products utilize Apio’s proprietary BreatheWay packaging technology. Apio’s strategy is to operate one large central processing facility in one of California’s largest, lowest cost growing regions (Santa Maria Valley) and use packaging technology to allow for the nationwide delivery of fresh produce products.
- **Export Capability:** Apio is uniquely positioned to benefit from the growth in export sales to Asia and Europe over the next decade with its export business, CalEx. Through CalEx, Apio is currently one of the largest U.S. exporters of broccoli to Asia and is selling its iceless products to Asia using proprietary BreatheWay packaging technology.

**Expanded Product Line Using Technology:** Apio, through the use of its BreatheWay packaging technology, is introducing on average fifteen new value-added products each year. These new product offerings range from various sizes of fresh-cut bagged products, to vegetable trays, to whole produce, to vegetable salads and snack packs. During the last twelve months, Apio has introduced 15 new products.

Apio established its Apio Packaging division (formerly known as Apio Tech) in 2005 to advance the sales of BreatheWay packaging technology for shelf-life sensitive vegetables and fruit. The technology also includes unique packaging solutions for produce in large packages including shipping and pallet-sized containers.

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

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

The Company recently expanded the use of its BreatheWay technology to avocados under an expanded licensing agreement with Chiquita. Market tests of avocados into the food service industry are underway.

### ***Technology Licensing Businesses***

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

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

Landec's Intellicoat seed coating applications are designed to control seed germination timing, increase crop yields, reduce risks and extend crop-planting windows. These coatings are currently available on hybrid corn, soybeans and male inbred corn used for seed production. In fiscal year 2000, Landec Ag launched its first commercial product, Pollinator Plus® coatings, which is a coating application used by seed companies as a method for spreading pollination to increase yields and reduce risk in the production of hybrid seed corn. There are approximately 650,000 acres of seed production in the United States and in 2007 Pollinator Plus was used by 25 seed companies on approximately 15% of the seed corn production acres in the U.S.

In 2003, Landec commercialized Early Plant® corn by selling the product directly to farmers through the Fielder's Choice Direct® brand. This application allows farmers to plant into cold soils without the risk of chilling injury, and enables farmers to plant as much as four weeks earlier than normal. With this capability, farmers are able to utilize labor and equipment more efficiently, provide flexibility during the critical planting period and avoid yield losses caused by late planting. In 2007, seven seed companies offered Intellicoat on their hybrid seed corn offerings.

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

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

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*Personal Care and Cosmetic Applications*

Landec's personal care and cosmetic applications strategy is focused on supplying Intelimer materials to industry leaders for use in lotions and creams, and potentially hair care products, color cosmetics and lipsticks. The Company's partner, Air Products, is currently shipping products to L'Oreal for use in lotions and creams.

*Intelimer Polymer Systems*

Landec has developed latent catalysts useful in extending pot-life, extending shelf life, reducing waste and improving thermoset cure methods. Some of these latent catalysts are currently being distributed by Akzo-Nobel Chemicals B.V. through our licensing agreement with Air Products. The rights to develop and sell Landec's latent catalysts and personal care technologies were licensed to Air Products in March 2006.

*Medical Applications*

On December 23, 2005, Landec entered into an exclusive licensing agreement with Aesthetic Sciences Corporation ("Aesthetic Sciences") for the exclusive rights to use Landec's Intelimer materials technology for the development of dermal fillers worldwide. Landec will receive royalties on the sale of products incorporating Landec's technology. In addition, the Company has received shares of preferred stock valued at \$1.8 million which represents a 19.9% ownership interest in Aesthetic Sciences. At this time, the Company is unable to predict the ultimate outcome of the collaboration with Aesthetic Sciences and the timing or amount of future revenues, if any.

**Results of Operations****Revenues** (in thousands):

	<i>Three months ended 2/24/08</i>	<i>Three months ended 2/25/07</i>	<i>Change</i>	<i>Nine months ended 2/24/08</i>	<i>Nine months ended 2/25/07</i>	<i>Change</i>
<b>Apio Value Added</b>	\$ 46,889	\$ 43,055	9%	\$ 125,547	\$ 113,897	10%
<b>Apio Packaging Technology</b>	1,873	1,298	44%	2,203	1,352	63%
<b>Subtotal</b>	48,762	44,353	10%	127,750	115,249	11%
<b>Apio Trading</b>	8,974	6,990	28%	48,279	41,389	17%
<b>Total Apio</b>	57,736	51,343	12%	176,029	156,638	12%
<b>Tech. Licensing</b>	1,871	1,612	16%	5,198	2,659	95%
<b>Total Revenues</b>	\$ 59,607	\$ 52,955	13%	\$ 181,227	\$ 159,297	14%

*Apio Value Added*

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

The increase in Apio's value-added revenues for the three and nine months ended February 24, 2008 compared to the same periods last year is due to increased product offerings, increased sales to existing customers and the addition of new customers. Overall value-added unit sales volume increased 17% and 18% for the three and nine months ended February 24, 2008, respectively, compared to the same periods of the prior year. The increases in value-added sales volumes were higher than the increases in revenues due primarily to the introduction of several new value-added

products during the third quarter and first nine months of fiscal year 2008 that have average sales prices per unit that are lower than the average sales prices per unit for other value-added products.

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*Apio Packaging*

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

The increase in revenues from Apio Packaging during the three and nine months ended February 24, 2008 compared to the same periods last year was not material to consolidated Landec revenues.

*Apio Trading*

Apio trading revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia through Apio's export company, Cal-Ex and from the purchase and sale of whole commodity fruit and vegetable products domestically to Wal-Mart. The export portion of trading revenues for the three and nine months ended February 24, 2008 was \$8.9 million and \$45.5 million, or 100% and 94%, respectively, of total trading revenues.

The increase in revenues in Apio's trading business for the three and nine months ended February 24, 2008 compared to the same periods last year was due to a 19% and 14%, respectively, increase in trading business sales volumes.

*Technology Licensing*

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

The increase in Technology Licensing revenues for the three months ended February 24, 2008 compared to the same period last year was not material to consolidated Landec revenues. The increase in Technology Licensing revenues for the nine months ended February 24, 2008 compared to the same period of the prior year was primarily due to the licensing revenues from the Monsanto license and supply agreement entered into on December 1, 2006.

**Gross Profit** (in thousands):

	<i>Three months ended 2/24/08</i>	<i>Three months ended 2/25/07</i>	<i>Change</i>	<i>Nine months ended 2/24/08</i>	<i>Nine months ended 2/25/07</i>	<i>Change</i>
<b>Apio Value Added</b>	\$ 6,434	\$ 5,654	14%	\$ 18,566	\$ 16,597	12%
<b>Apio Packaging</b>	1,852	1,261	47%	2,116	1,281	65%
<b>Technology</b>						
<b>Subtotal</b>	8,286	6,915	20%	20,682	17,878	16%
<b>Apio Trading</b>	590	538	10%	2,697	2,570	5%
<b>Total Apio</b>	8,876	7,453	19%	23,379	20,448	14%
<b>Tech. Licensing</b>	1,871	1,637	14%	5,198	2,475	110%
<b>Total Gross Profit</b>	\$ 10,747	\$ 9,090	18%	\$ 28,577	\$ 22,923	25%

*General*

There are numerous factors that can influence gross profits including product mix, customer mix, manufacturing costs, volume, sale discounts and charges for excess or obsolete inventory, to name a few. Many of these factors influence or are interrelated with other factors. Therefore, it is difficult to precisely quantify the impact of each item individually. The Company includes in cost of sales all the costs related to the sale of products in accordance with U.S. generally accepted accounting principles. These costs include the following: raw materials (including produce, seeds and packaging), direct labor, overhead (including indirect labor, depreciation, and facility related costs) and shipping and

shipping related costs. The following discussion surrounding gross profit includes management's best estimates of the reasons for the changes for the three and nine months ended February 24, 2008, compared to the same periods last year as outlined in the table above.

*Apio Value-Added*

The increase in gross profit for Apio's value-added specialty packaging vegetable business for the three months and nine months ended February 24, 2008 compared to the same periods last year was primarily due to an increase in value-added sales and resulting from favorable produce sourcing during the three and nine months ended February 24, 2008 compared to the same periods of fiscal year 2007.

*Apio Packaging*

The increase in gross profit for Apio Packaging for the three and nine months ended February 24, 2008 compared to the same periods last year was primarily due to the increase in minimum payments received from Chiquita as a result of the amended Chiquita licensing agreement (see Note 2).

*Apio Trading*

Apio's trading business is a buy/sell business that realizes a commission-based margin in the 4-6% range. The increase in Apio trading gross profit for the three and nine months ended February 24, 2008 compared to the same periods last year was not material to consolidated Landec gross profit.

*Technology Licensing*

The increase in Technology Licensing gross profit for the three months ended February 24, 2008 compared to the same period of the prior year was primarily due to an increase in gross profit from the Air Products collaboration. The increase in Technology Licensing gross profit for the nine months ended February 24, 2008 compared to the same period last year was due to the increase in gross profit from the Air Products collaboration and from an increase in gross profit from the Monsanto licensing agreement entered into on December 1, 2006.

**Operating Expenses** (in thousands):

	<i>Three months ended 2/24/08</i>	<i>Three months ended 2/25/07</i>	<i>Change</i>	<i>Nine months ended 2/24/08</i>	<i>Nine months ended 2/25/07</i>	<i>Change</i>
<b>Research and Development:</b>						
<i>Apio</i>	\$ 253	\$ 244	4%	\$ 908	\$ 808	12%
<i>Tech. Licensing</i>	549	419	31%	1,503	1,479	2%
<b>Total R&amp;D</b>	\$ 802	\$ 663	21%	\$ 2,411	\$ 2,287	5%
<b>Selling, General and Administrative:</b>						
<i>Apio</i>	\$ 3,722	\$ 3,228	15%	\$ 10,423	\$ 9,362	11%
<i>Corporate</i>	1,101	1,611	(32%)	3,185	7,668	(58%)
<b>Total S,G&amp;A</b>	\$ 4,823	\$ 4,839	(0%)	\$ 13,608	\$ 17,030	(20%)

*Research and Development*

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

The increase in research and development expenses for the three and nine months ended February 24, 2008 compared to the same periods last year was not material.

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*Selling, General and Administrative*

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

The decrease in selling, general and administrative expenses for the three months ended February 24, 2008 compared to the same period last year was not material. The decrease in selling, general and administrative expenses for the nine months ended February 24, 2008 was primarily due to the fact that selling, general and administrative expenses for Corporate for the nine months ended February 25, 2007 included \$5.6 million in expenses from Landec's former direct marketing and sales seed business that was sold to Monsanto in December 2006. This was partially offset by the recording of net proceeds of \$1.5 million from an insurance settlement.

**Other** (in thousands):

	<i>Three months ended 2/24/08</i>	<i>Three months ended 2/25/07</i>	<i>Change</i>	<i>Nine months ended 2/24/08</i>	<i>Nine months ended 2/25/07</i>	<i>Change</i>
<b>Interest Income</b>	\$ 527	\$ 662	(20%)	\$ 1,915	\$ 1,075	78%
<b>Interest Expense</b>	(5)	(57)	(91%)	(18)	(248)	(93%)
<b>Minority Int. Exp.</b>	(121)	(137)	(12%)	(350)	(252)	39%
<b>Other Income (Exp.)</b>	(37)		N/M	(37)	(2)	N/M
<b>Total Other</b>	\$ 364	\$ 468	(22%)	\$ 1,510	\$ 573	164%
<b>Income Taxes</b>	\$ 1,520	\$ 2,101	(28%)	\$ 3,900	\$ 2,101	86%

*Interest Income*

The decrease in interest income for the three months ended February 24, 2008 compared to the same period last year was due to the decrease in cash available for investing as a result of the repurchase of Apio common stock and options in August 2007. The increase in interest income for the nine months ended February 24, 2008 compared to the same period last year was due to the increase in cash available for investing as a result of the cash received from the sale of FCD in December 2006.

*Interest Expense*

The decrease in interest expense during the three and nine months ended February 24, 2008 compared to the same periods last year was due to the reduction of the Company's debt.

*Minority Interest Expense*

The minority interest expense consists of the minority interest associated with the limited partners' equity interest in the net income of Apio Cooling, LP. The decrease in the minority interest for the three months ended February 24, 2008 and the increase in minority interest for the nine months ended February 24, 2008 compared to the same periods last year was not material to consolidated Landec net income.

*Other Income (Expense)*

Other income (expense) consists of non-operating income and expenses.

*Income Taxes*

The decrease in the income tax expense for the three months ended February 24, 2008 was due to the gain on the sale of FCD during the third quarter last year which resulted in the tax expense that was recorded last year. The increase in the tax expense for the nine months ended February 24, 2008 compared to the same period last year was due to an increase in the Company's effective tax rate from 8% last year to 28% this year due to the decrease in the deferred income tax valuation allowance and fully utilizing the Company's net operating loss carryforward and tax credits during fiscal year 2008.

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## **Liquidity and Capital Resources**

As of February 24, 2008, the Company had cash and cash equivalents of \$55.3 million, a net decrease of \$7.3 million from \$62.6 million at May 27, 2007.

### *Cash Flow from Operating Activities*

Landec generated \$15.1 million of cash flow from operating activities during the nine months ended February 24, 2008 compared to using \$7.2 million in operating activities during the nine months ended February 25, 2007. The primary sources of cash from operating activities were from net income of \$10.2 million and non-cash related expenses of \$6.4 million, such as depreciation, income tax expense not payable and stock based compensation. The sources of cash were partially offset by a decrease in current assets net of current liabilities of \$1.5 million.

### *Cash Flow from Investing Activities*

Net cash used in investing activities for the nine months ended February 24, 2008 was \$2.3 million compared to cash provided by investing activities of \$42.5 million for the same period last year due primarily to the sale of FCD. The primary uses of cash from investing activities during the first nine months of fiscal year 2008 were for the purchase of \$2.4 million of property and equipment primarily for the growth of Apio's value-added processing business.

### *Cash Flow from Financing Activities*

Net cash used in financing activities for the nine months ended February 24, 2008 was \$20.1 million compared to net cash provided by financing activities of \$2.4 million for the same period last year. The primary uses of cash from financing activities during the first nine months of fiscal year 2008 were for the repurchase of all of the outstanding common stock and options of Apio not owned by Landec for \$20.8 million.

### *Capital Expenditures*

During the nine months ended February 24, 2008, Landec purchased property and equipment to support the growth of Apio's value added processing business. These expenditures represented the majority of the \$2.4 million of capital expenditures.

### *Debt*

Apio has a \$7.0 million revolving line of credit with Wells Fargo Bank N.A. On September 1, 2007, Apio amended its revolving line of credit with Wells Fargo Bank N.A. by extending the term of the line to August 31, 2009. In addition, the interest rate on the revolving line of credit was reduced to either prime less 0.75% or the LIBOR adjusted rate plus 1.50%. The revolving line of credit with Wells Fargo contains certain restrictive covenants, which require Apio to meet certain financial tests, including minimum levels of net income, maximum leverage ratio, minimum net worth and maximum capital expenditures. Landec has pledged substantially all of the assets of Apio to secure the line with Wells Fargo. At February 24, 2008, no amounts were outstanding under the revolving line of credit. Apio has been in compliance with all loan covenants during the nine months ended February 24, 2008.

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

Landec's future capital requirements will depend on numerous factors, including the progress of its research and development programs; the continued development of marketing, sales and distribution capabilities; the ability of Landec to establish and maintain new collaborative and licensing arrangements; any decision to pursue additional

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

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

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

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

### ***The Audit of Our Financial Statements May Result in Changes to Our Financial Statements***

As previously reported, the Company had delayed the release of its fiscal third quarter 2008 results and the filing of its Form 10-Q for the same period in order to allow the Company’s newly appointed independent registered public accounting firm, McGladrey & Pullen, LLP (“M&P”), adequate time to complete its review of the Company’s third quarter financial statements. M&P has raised some questions regarding the interpretation of certain complex technical accounting rules affecting the accounting treatment for the transactions entered into with Monsanto Corporation and its subsidiaries (“Monsanto”) on December 1, 2006 (which include the sale by Landec to American Seeds, Inc., a wholly owned subsidiary of Monsanto, of Landec’s direct marketing and sales seed company, Fielder’s Choice Direct (“FCD”) which included the Fielder’s Choice Direct® and Heartland Hybrid® brands, the entry into a five-year co-exclusive technology license and polymer supply agreement on the same date with Monsanto for the use of Landec’s Intellicoat® polymer coating technology and the purchase of all of the common stock and options of Landec Ag, Inc., not owned by Landec (collectively, the “Monsanto transactions”)) and the repurchase by Landec on August 7, 2007 of all of the common stock and options of Apio, Inc., Landec’s food technology subsidiary, not owned by Landec (the “Apio transaction”).

M&P completed its review of the Company’s third quarter financial statements without any changes, and the Company filed its Form 10-Q for the period ended February 24, 2008 with the Securities and Exchange Commission. However, a review of interim financial statements is substantially less in scope than an audit performed in accordance with generally accepted auditing standards and there can be no assurance that there will not be changes made to the Company’s financial statements when M&P completes its audit of the Company’s financial statements for the fiscal year ended May 25, 2008. Management and M&P are continuing to review the related generally accepted accounting principles applicable to the Monsanto transactions and the Apio transaction and they intend to resolve any issues by the time M&P completes its audit of the Company’s financial statements for the fiscal year ended May 25, 2008. At this time, the Company cannot predict the outcome of such review.

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

In the past, our results of operations have fluctuated significantly from quarter to quarter and are expected to continue to fluctuate in the future. Historically, Landec Ag has been the primary source of these fluctuations, as its revenues and profits were concentrated over a few months during the spring planting season (generally during our third and fourth fiscal quarters). In addition, Apio can be heavily affected by seasonal and weather factors which have impacted quarterly results, such as the high cost of sourcing product in June/July 2006 and January 2007 due to a shortage of essential value-added produce items. Our earnings may also fluctuate based on our ability to collect accounts receivables from customers and note receivables from growers and on price fluctuations in the fresh vegetables and fruits markets. Other factors that affect our food and/or agricultural operations include:

the seasonality of our supplies;



our ability to process produce during critical harvest periods;

the timing and effects of ripening;

the degree of perishability;

the effectiveness of worldwide distribution systems;

total worldwide industry volumes;

the seasonality of consumer demand;

foreign currency fluctuations; and

foreign importation restrictions and foreign political risks.

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

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

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

price;

safety;

efficacy;

reliability;

conversion costs;

marketing and sales efforts; and

general economic conditions affecting purchasing patterns.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- fines, injunctions, civil penalties, and suspensions,
- withdrawal of regulatory approvals,
- product recalls and product seizures, including cessation of manufacturing and sales,
- operating restrictions, and
- criminal prosecution.

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

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

For the nine months ended February 24, 2008, approximately 25% of our total revenues were derived from product sales to international customers. A number of risks are inherent in international transactions. International sales and operations may be limited or disrupted by any of the following:

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

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

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

During the nine months ended February 24, 2008, sales to our top five customers accounted for approximately 47% of our revenues, with our largest customer, Costco Wholesale Corp., accounting for approximately 19% of our revenues.

We expect that, for the foreseeable future, a limited number of customers may continue to account for a substantial portion of our net revenues. We may experience changes in the composition of our customer base as we have experienced in the past. We do not have long-term purchase agreements with any of our customers. The reduction, delay or cancellation of orders from one or more major customers for any reason or the loss of one or more of our major customers could materially and adversely affect our business, operating results and financial condition. In addition, since some of the products processed by Apio at its Guadalupe, California facility are sole sourced to its customers, our operating results could be adversely affected if one or more of our major customers were to develop other sources of supply. Our current customers may not continue to place orders, orders by existing customers may be canceled or may not continue at the levels of previous periods or we may not be able to obtain orders from new customers.

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

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

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

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

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

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

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

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

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

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

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

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

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

Our Board of Directors has the authority, without further approval of our shareholders, to fix the rights and preferences, and to issue shares, of preferred stock. In November 1999, we issued and sold shares of Series A Convertible Preferred Stock and in October 2001 we issued and sold shares of Series B Convertible Preferred Stock. The Series A Convertible Preferred Stock was converted into 1,666,670 shares of Common Stock on November 19, 2002 and the Series B Convertible Preferred Stock was converted into 1,744,102 shares of Common Stock on May 7, 2004.

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

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

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

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

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

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

None.

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

**Evaluation of Disclosure Controls and Procedures**

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

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal controls over financial reporting during the quarter ended February 24, 2008 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

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

### **Item 1A. Risk Factors**

#### ***The Audit of Our Financial Statements May Result in Changes to Our Financial Statements***

As previously reported, the Company had delayed the release of its fiscal third quarter 2008 results and the filing of its Form 10-Q for the same period in order to allow the Company's newly appointed independent registered public accounting firm, McGladrey & Pullen, LLP ("M&P"), adequate time to complete its review of the Company's third quarter financial statements. M&P has raised some questions regarding the interpretation of certain complex technical accounting rules affecting the accounting treatment for the transactions entered into with Monsanto Corporation and its subsidiaries ("Monsanto") on December 1, 2006 (which include the sale by Landec to American Seeds, Inc., a wholly owned subsidiary of Monsanto, of Landec's direct marketing and sales seed company, Fielder's Choice Direct ("FCD") which included the Fielder's Choice Direct® and Heartland Hybrid® brands, the entry into a five-year co-exclusive technology license and polymer supply agreement on the same date with Monsanto for the use of Landec's Intellicoat® polymer coating technology and the purchase of all of the common stock and options of Landec Ag, Inc., not owned by Landec (collectively, the "Monsanto transactions")) and the repurchase by Landec on August 7, 2007 of all of the common stock and options of Apio, Inc., Landec's food technology subsidiary, not owned by Landec (the "Apio transaction").

M&P completed its review of the Company's third quarter financial statements without any changes, and the Company filed its Form 10-Q for the period ended February 24, 2008 with the Securities and Exchange Commission. However, a review of interim financial statements is substantially less in scope than an audit performed in accordance with generally accepted auditing standards and there can be no assurance that there will not be changes made to the Company's financial statements when M&P completes its audit of the Company's financial statements for the fiscal year ended May 25, 2008. Management and M&P are continuing to review the related generally accepted accounting principles applicable to the Monsanto transactions and the Apio transaction and they intend to resolve any issues by the time M&P completes its audit of the Company's financial statements for the fiscal year ended May 25, 2008. At this time, the Company cannot predict the outcome of such review.

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

None.

### **Item 3. Defaults Upon Senior Securities**

None.

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

None.

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

Exhibit

	<u>Number</u>	<u>Exhibit Title:</u>
	31.1+	CEO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
	31.2+	CFO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
	32.1+	CEO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
	32.2+	CFO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

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+ Filed herewith.

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**SIGNATURES**

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

LANDEC CORPORATION

By: /s/ Gregory S. Skinner

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

Date: April 9, 2008

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