

# LANDEC CORP \CA\

## FORM 10-K (Annual Report)

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

**FORM 10-K**

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

For the Fiscal Year Ended May 25, 2008, or

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

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

Commission file number: **0-27446**

**LANDEC CORPORATION**

(Exact name of registrant as specified in its charter)

**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**

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

Title of each class

Name of each exchange on which registered

Common Stock

The NASDAQ Stock Market, Inc.

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

None

(Title of Class)

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

Yes  No

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

Yes  No

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

Yes  No

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

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

Large Accelerated Filer

Accelerated Filer

Non Accelerated Filer

Smaller Reporting Company

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

Yes  No

The aggregate market value of voting stock held by non-affiliates of the Registrant was approximately \$291,230,000 as of November 25, 2007, the last business day of the registrant’s most recently completed second fiscal quarter, based upon the closing sales price on The NASDAQ Global Select Market reported for such date. Shares of Common Stock held by each officer and director and by each person who owns 10% or more of the outstanding Common Stock have been excluded from such calculation in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of July 18 , 2008, there were 26,164,653 shares of Common Stock outstanding.

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

Portions of the registrant’s definitive proxy statement relating to its October 2008 Annual Meeting of Shareholders, which statement will be filed not later than 120 days after the end of the fiscal year covered by this report, are incorporated by reference in Part III hereof.

**LANDEC CORPORATION**  
ANNUAL REPORT ON FORM 10-K

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## PART I

### Item 1. *Business*

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

#### General

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’s proprietary polymer technology is the foundation, and a key differentiating advantage, upon which Landec has built its business.

On December 1, 2006, Landec sold its direct marketing and sales seed company, Fielder’s Choice Direct (“FCD”), which included the Fielder’s Choice Direct<sup>®</sup> and Heartland Hybrid<sup>®</sup> brands, to American Seeds, Inc., a wholly owned subsidiary of Monsanto Company (“Monsanto”). Subsequent to the sale of FCD, Landec now has three core businesses - Food Products Technology, Commodity Trading and Technology Licensing which are described below. Financial information concerning the industry segments for which the Company reported its operations during fiscal years 2006, 2007 and 2008 is summarized in Note 14 to the Consolidated Financial Statements.

Our Food Products Technology business is operated through a subsidiary, Apio, Inc. (“Apio”), and combines our proprietary food packaging technology with the capabilities of a large national food supplier and value-added produce processor. Value-added processing uses Landec’s proprietary BreatheWay<sup>®</sup> packaging technology to package produce that is processed by washing, and in some cases cutting and mixing, resulting in packaged produce that achieves increased shelf life and reduced shrink (waste) and eliminates the need for ice during distribution.

Our Commodity Trading business is operated through Apio, Inc. and combines Apio’s export company, Cal Ex Trading Company (“Cal-Ex”) with Apio’s domestic buy-sell commodity business that purchases and sells whole fruit and vegetable products to Asia and domestically to Wal-Mart.

Our Technology Licensing business includes the licensing of proprietary Intellicoat<sup>®</sup> 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”).

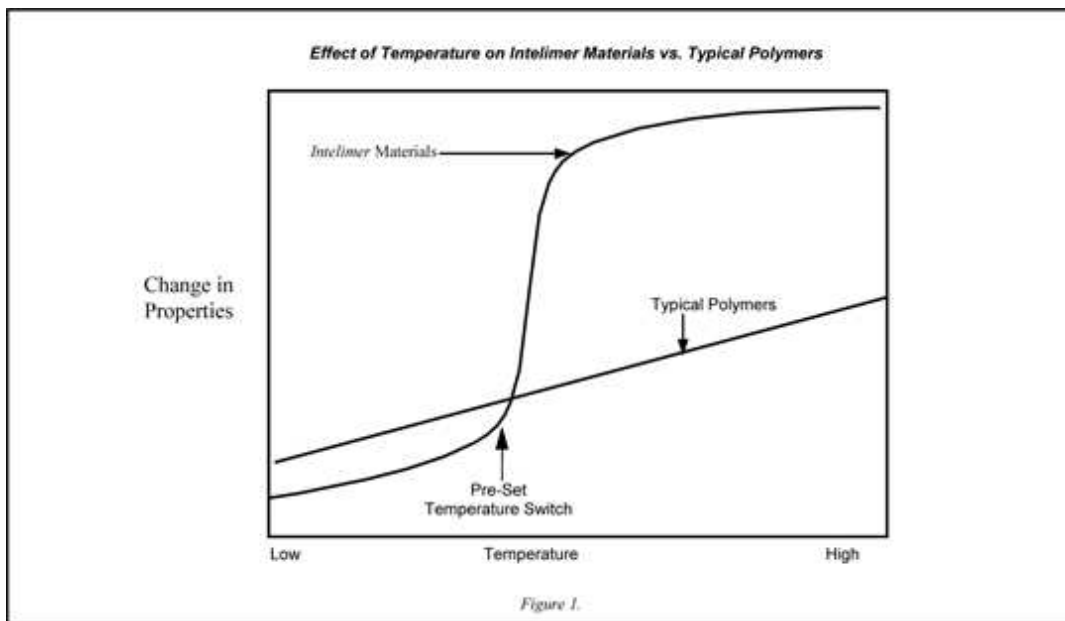
The Company’s core polymer products are based on its patented proprietary Intelimer<sup>®</sup> polymers, which differ from other polymers in that they can be customized to abruptly change their physical characteristics when heated or cooled through a pre-set temperature switch. For instance, Intelimer 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 liquid state. These abrupt changes are repeatedly reversible and can be tailored by Landec to occur at specific temperatures, thereby offering substantial competitive advantages in the Company’s target markets.

The Company was incorporated in California on October 31, 1986. The Company completed its initial public offering in 1996 and is listed on The NASDAQ Global Select Market under the symbol “LNDC”.

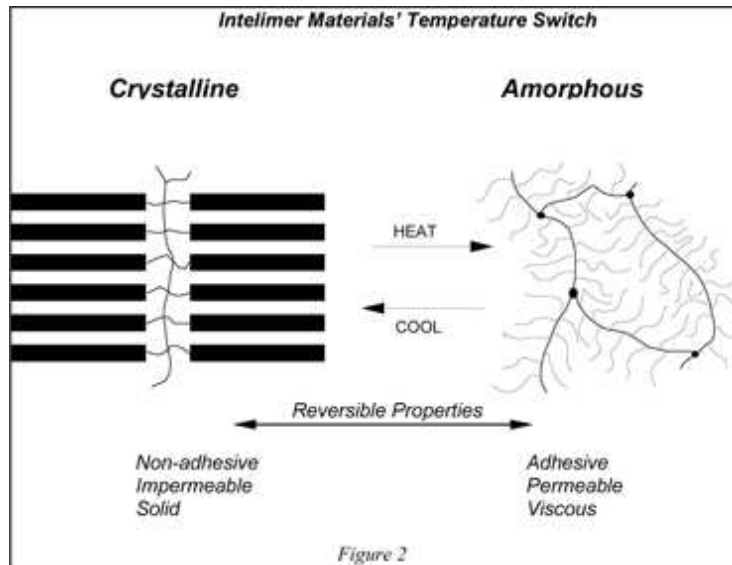
## Technology Overview

Polymers are important and versatile materials found in many of the products of modern life. Certain polymers, such as cellulose and natural rubber, occur in nature. Man-made polymers include nylon fibers used in carpeting and clothing, coatings used in paints and finishes, plastics such as polyethylene, and elastomers used in automobile tires and latex gloves. Historically, synthetic polymers have been designed and developed primarily for improved mechanical and thermal properties, such as strength and the ability to withstand high temperatures. Improvements in these and other properties and the ease of manufacturing of synthetic polymers have allowed these materials to replace wood, metal and natural fibers in many applications over the last 50 years. More recently, scientists have focused their efforts on identifying and developing sophisticated polymers with novel properties for a variety of commercial applications.

Landec's Intelimer polymers are a proprietary class of synthetic polymeric materials that respond to temperature changes in a controllable, predictable way. Typically, polymers gradually change in adhesion, permeability and viscosity over broad temperature ranges. Landec's Intelimer materials, in contrast, can be designed to exhibit abrupt changes in permeability, adhesion and/or viscosity over temperature ranges as narrow as  $1^{\circ}\text{C}$  to  $2^{\circ}\text{C}$ . These changes can be designed to occur at relatively low temperatures ( $0^{\circ}\text{C}$  to  $100^{\circ}\text{C}$ ) that are relatively easy to maintain in industrial and commercial environments. *Figure 1* illustrates the effect of temperature on Intelimer materials as compared to typical polymers.



Landec's proprietary polymer technology is based on the structure and phase behavior of Intelimer materials. The abrupt thermal transitions of specific Intelimer materials are achieved through the controlled use of hydrocarbon side chains that are attached to a polymer backbone. Below a pre-determined switch temperature, the polymer's side chains align through weak hydrophobic interactions resulting in a crystalline structure. When this side chain crystallizable polymer is heated to, or above, this switch temperature, these interactions are disrupted and the polymer is transformed into an amorphous, viscous state. Because this transformation involves a physical and not a chemical change, this process is repeatedly reversible. Landec can set the polymer switch temperature anywhere between  $0^{\circ}\text{C}$  to  $100^{\circ}\text{C}$  by varying the length of the side chains. The reversible transitions between crystalline and amorphous states are illustrated in *Figure 2* below.

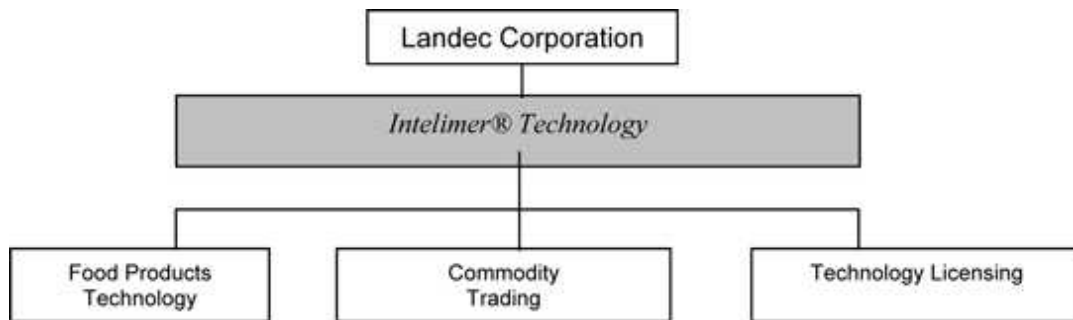


Side chain crystallizable polymers were first discovered by academic researchers in the mid-1950's. These polymers were initially considered to be merely of scientific curiosity from a polymer physics perspective, and, to the Company's knowledge, no significant commercial applications were pursued. In the mid-1980's, Dr. Ray Stewart, the Company's founder, became interested in the idea of using the temperature-activated permeability properties of these polymers to deliver various materials such as catalysts and pesticides. After forming Landec in 1986, Dr. Stewart subsequently discovered broader utility for these polymers. After several years of basic research, commercial development efforts began in the early 1990's, resulting in initial products in mid-1994.

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

**Description of Core Business**

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



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

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

### *The Technology and Market Opportunity: Proprietary BreatheWay Packaging Technology*

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

Fresh-cut produce is pre-washed, cut and packaged in a form that is ready to use by the consumer and is thus typically sold at premium price levels compared to unpackaged produce. The total U.S. fresh produce market is estimated to be \$100 billion to \$120 billion. Of this, U.S. retail sales of fresh-cut produce is estimated to comprise 10% of the fresh produce market. The Company believes that the growth of this market has been driven by consumer demand and the willingness to pay for convenience, freshness, uniform quality, safety and nutritious produce delivered to the point of sale. According to the International Fresh-Cut Produce Association, the fresh-cut produce market is one of the highest growth areas in retail grocery stores.

Although fresh-cut produce companies have had success in the salad market, the industry has been slow to diversify into other fresh-cut vegetables or fruits due primarily to limitations in film and plastic tray materials used to package fresh-cut produce. After harvesting, vegetables and fruit continue to respire, consuming oxygen and releasing carbon dioxide. Too much or too little oxygen can result in premature spoilage and decay and, in some cases, promote the growth of microorganisms that jeopardize inherent food safety. Conventional packaging films used today, such as polyethylene and polypropylene, can be made with modest permeability to oxygen and carbon dioxide, but often do not provide the optimal atmosphere for the produce. Shortcomings of conventional packaging materials have not significantly hindered the growth in the fresh-cut salad market because lettuce, unlike many vegetables and fruit, has low respiration requirements.

The respiration rate of produce varies from vegetable-to-vegetable and from fruit-to-fruit. The challenge facing the industry is to develop packaging for the high respiring, high value and shelf life sensitive vegetable and fruit markets. The Company believes that today's conventional packaging films face numerous challenges in adapting to meet the diversification of pre-cut vegetables and fruit evolving in the industry without compromising shelf life and produce quality. To mirror the growth experienced in the fresh-cut salad market, the markets for high respiring vegetables and fruit such as broccoli, cauliflower, asparagus, papayas, bananas and berries will require a more versatile and sophisticated packaging solution for which the Company's BreatheWay packaging technology was developed.

The respiration rate of produce also varies with temperature. As temperature increases, produce generally respire at a higher rate, which speeds up the aging process, resulting in shortened shelf life and increased potential for decay, spoilage, and loss of texture and dehydration. As produce is transported from the processing plant through the refrigerated distribution chain to foodservice locations, retail grocery stores and club stores, and finally to the ultimate consumer, temperatures can fluctuate significantly. Therefore, temperature control is a constant challenge in preserving the quality of fresh-cut and whole produce — a challenge for which few current packaging films can compensate. The Company believes that its temperature-responsive BreatheWay packaging technology is well suited to the challenges of the produce distribution process.



Using its Intelimer polymer technology, Landec has developed packaging technology that it believes addresses many of the shortcomings of conventional packaging materials. A membrane is applied over a small cutout section or an aperture of a flexible film bag or plastic tray. This highly permeable “window” acts as the mechanism to provide the majority of the gas transmission requirements for the entire package. These membranes are designed to provide three principal benefits:

- *High Permeability.* Landec's BreatheWay packaging technology is designed to permit transmission of oxygen and carbon dioxide at 300 times the rate of conventional packaging films. The Company believes that these higher permeability levels will facilitate the packaging diversity required to market many types of fresh-cut and whole produce.
- *Ability to Adjust Oxygen and Carbon Dioxide Permeability.* BreatheWay packaging can be tailored with carbon dioxide to oxygen transfer ratios ranging from 1.0 to 12.0 and selectively transmit oxygen and carbon dioxide at optimum rates to sustain the quality and shelf life of packaged produce.
- *Temperature Responsiveness.* Landec has developed breathable membranes that can be designed to increase or decrease permeability in response to environmental temperature changes. The Company has developed packaging that responds to higher oxygen requirements at elevated temperatures but is also reversible, and returns to its original state as temperatures decline. The temperature responsiveness of these membranes allows ice to be removed from the distribution system which results in numerous benefits. These benefits include (1) a substantial decrease in freight cost, (2) reduced risk of contaminated produce because ice can be a carrier of micro organisms, (3) the elimination of expensive waxed cartons that cannot be recycled, and (4) the potential decrease in work related accidents due to melted ice.

Landec believes that growth of the overall produce market will be driven by the increasing demand for the convenience of fresh-cut produce. This demand will in turn require packaging that facilitates the quality and shelf life of produce transported to fresh-cut distributors in bulk and pallet quantities. The Company believes that in the future its BreatheWay packaging technology will be useful for packaging a diverse variety of fresh-cut and whole produce products. Potential opportunities for using Landec's technology outside of the produce market exist in cut flowers and in other food products.

Landec is working with leaders in the club store, retail grocery chain and foodservice markets. The Company believes it will have growth opportunities for the next several years through new customers and products in the United States, expansion of its existing customer relationships, and through export and shipments of specialty packaged produce.

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

#### *The Business: Food Products Technology*

Our Food Products Technology business, operated through our Apio subsidiary, had revenues of approximately \$171 million for the fiscal year ended May 25, 2008, \$156 million for the fiscal year ended May 27, 2007 and \$137 million for the fiscal year ended May 28, 2006.

Based in Guadalupe, California, Apio's primary business surrounds specialty packaged fresh-cut and whole value-added processed products that are washed and packaged in our proprietary BreatheWay packaging. The fresh-cut value-added processed products business markets a variety of fresh-cut and whole vegetables to the top retail grocery chains, club stores and foodservice suppliers. During the fiscal year ended May 25, 2008, Apio shipped nearly nineteen million cartons of produce to leading supermarket retailers, wholesalers, foodservice suppliers and club stores throughout North America, primarily in the United States.

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

- **Value-Added Supplier:** Apio has structured its business as a marketer and seller of fresh-cut and whole value-added produce. It is focused on selling products under its Eat Smart® brand and other brands for its fresh-cut and whole value-added products. As retail grocery and club store chains consolidate, Apio is well positioned as a single source of a broad range of products.
- **Reduced Farming Risks:** Apio reduces its farming risk by not taking ownership of farmland, and instead, contracts with growers for produce. The year-round sourcing of produce is a key component to the fresh-cut and whole value-added processing business.
- **Lower Cost Structure:** Apio has strategically invested in the rapidly growing fresh-cut and whole value-added produce 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.
- **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 20 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 Brands International, Inc. ("Chiquita") with its proprietary banana packaging technology on a worldwide basis for the ripening, conservation and shelf-life extension of bananas for most applications on an exclusive basis and for other applications on a non-exclusive basis. In addition, Apio provides Chiquita with ongoing research and development and process technology support for the BreatheWay membranes and bags, and technical service support throughout the customer chain in order to assist in the development and market acceptance of the technology.

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

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

The Company recently expanded the use of its BreatheWay technology to avocados under an expanded licensing agreement with Chiquita. Commercial sales of avocados into the food service industry recently began.

The Company's specialty packaging for case liner products reduces freight expense up to 50% for certain produce commodities by eliminating the weight and space consumed by ice. In addition to reducing the cost of freight, the removal of ice from the distribution system offers additional benefits as outlined above.

Product enhancements in the fresh-cut vegetable line include fresh-cut vegetable trays designed to look like they were freshly made in the retail grocery store or at home. The rectangular tray design is convenient for storage in consumers' refrigerators and expands the Company's wide-ranging vegetable tray line.

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

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

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

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

Commodity Trading revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia through Apio's export company, Cal-Ex and from the purchase and sale of whole commodity fruit and vegetable products domestically to Wal-Mart. The Commodity Trading business is a buy/sell business that realizes a commission-based margin in the 4-6% range.

#### *The Business: Commodity Trading*

Commodity Trading had revenues of approximately \$60 million for the fiscal year ended May 25, 2008, \$50 million for the fiscal year ended May 27, 2007 and \$58 million for the fiscal year ended May 28, 2006.

Apio is uniquely positioned to benefit from the growth in export sales to Asia and Europe over the next decade with Cal-Ex. Through Cal-Ex, 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.

### ***Technology Licensing Business***

#### *Seeds Business - Intellicoat Seed Coatings and Landec Ag*

Landec Ag had revenues of approximately \$5.4 million for the fiscal year ended May 25, 2008, \$2.8 million for the fiscal year ended May 27, 2007 and \$34.1 million for the fiscal year ended May 28, 2006. Revenues for fiscal years 2008 and 2007 declined significantly from fiscal year 2006 as a result of the sale of FCD on December 1, 2006.

Following the sale of FCD on December 1, 2006, Landec Ag's strategy has been to work closely with Monsanto to further develop its patented, functional polymer coating technology that can be broadly sold and/or licensed to the seed industry. In accordance with its license, supply and R&D agreement with Monsanto, Landec Ag is currently focused on commercializing products for the seed corn market and then plans to broaden the technology to other seed crop applications.

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

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 2008 Pollinator Plus was used by 25 seed companies on approximately 17% of the seed corn production acres in the U.S.

Beginning 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 2008, five seed companies offered Intellicoat on their hybrid seed corn offerings.

Monsanto announced several months ago that it has formed a new business called the Seed Treatment Business which will allow Monsanto to develop its seed treatment requirements internally. The concept of seed treatments is to place an insecticide or fungicide directly onto the seed surface in order to protect the seed and the seedling as it emerges. Landec's Intellicoat® seed coating technology could be an integral and proprietary part of Monsanto's commitment to building a major position in seed treatments worldwide by using Landec's seed coatings as a "carrier" of insecticides/fungicides which can be dispensed at the appropriate time based on time or soil temperature. During fiscal year 2009 we will be focused on validating the use of Landec's coating technology for these applications.

#### *Landec Ag - Sale of FCD*

The acquisition price for FCD was \$50 million in cash paid at the close. In addition, the Company could have earned up to an additional \$5 million based on FCD results for the twelve months ended May 31, 2007. None of the earn-out was earned. During the 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 with the assistance of an independent appraiser.

On December 1, 2006, Landec also entered into a five-year co-exclusive technology license and polymer supply agreement ("the Agreement") with Monsanto for the use of Landec's Intellicoat polymer seed coating technology. Under the terms of the Agreement, Monsanto will pay Landec Ag \$2.6 million per year in exchange for (1) a co-exclusive right to use Landec's Intellicoat temperature activated seed coating technology worldwide during the license period, (2) the right to be the exclusive global sales and marketing agent for the Intellicoat seed coating technology, and (3) the right to purchase the 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 fiscal years ended May 25, 2008 and May 27, 2007, Landec recognized \$5.4 million and \$2.7 million, respectively, in revenues and income from the Agreement.

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

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

### ***Non-Seeds Business***

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

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

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

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

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

#### ***Personal Care and Cosmetic Applications***

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

#### ***Medical Applications***

On December 23, 2005, Landec entered into an exclusive licensing agreement with Aesthetic Sciences Corporation ("Aesthetic Sciences"). Aesthetic Sciences paid Landec an upfront license fee of \$250,000 for the exclusive rights to use Landec's Intelimer materials technology for the development of dermal fillers worldwide. Landec will also receive royalties on the sale of products incorporating Landec's technology. In addition, the Company has received shares of preferred stock valued at \$1.8 million which as of May 25, 2008 represented 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.

### **Sales and Marketing**

Each of the Company's core businesses are supported by dedicated sales and marketing resources. The Company intends to develop its internal sales capacity as more products progress toward commercialization and as business volume expands geographically. During fiscal years 2008, 2007 and 2006, sales to the Company's top five customers accounted for approximately 47%, 50% and 46%, respectively, of its revenues, with the top customer, Costco Wholesale Corp., accounting for approximately 20%, 21% and 16%, respectively, of the Company's revenues.

## *Apio*

Apio has 22 sales people, located in central California and throughout the U.S., supporting the export business and the specialty packaged value-added produce business.

## *Seasonality*

The Company's sales are moderately seasonal. Prior to the sale of FCD, Landec Ag revenues and profits were concentrated over a few months during the spring planting season (generally during the Company's third and fourth fiscal quarters). In addition, the Food Products Technology business can be heavily affected by seasonal weather factors which have impacted quarterly results, such as high cost of sourcing product in June/July 2006 and January 2007 due to a shortage of essential value-added produce items. The Commodity Trading business also typically recognized a much higher percentage of its revenues and profit during the first half of Landec's fiscal year compared to the second half.

## **Manufacturing and Processing**

### *Food Products Technology Business*

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

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

### *Technology Licensing Business*

The Company performs its batch coating operations in a leased facility in Oxford, Indiana. This facility is being used to coat other seed companies' inbred seed corn with the Company's Pollinator Plus seed corn coatings.

The Company has a pilot manufacturing facility in Indiana to support process development, scale-up and commercialization of the Company's seed coating programs. This facility utilizes a continuous coating process that has increased seed coating capabilities by over tenfold compared to the previous system using batch coaters.

## *General*

Many of the raw materials used in manufacturing certain of the Company's products are currently purchased from a single source, including certain monomers used to synthesize Intelimer polymers and substrate materials for the Company's breathable membranes. Upon manufacturing scale-up of seed coating operations, the Company may enter into alternative supply arrangements. Although to date the Company has not experienced difficulty acquiring materials for the manufacture of its products, no assurance can be given that interruptions in supplies will not occur in the future, that the Company will be able to obtain substitute vendors, or that the Company will be able to procure comparable materials at similar prices and terms within a reasonable time. Any such interruption of supply could have a material adverse effect on the Company's ability to manufacture and distribute its products and, consequently, could materially and adversely affect the Company's business, operating results and financial condition.

## **Research and Development**

Landec is focusing its research and development resources on both existing and new applications of its Intelimer technology. Expenditures for research and development for the fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006 were \$3.3 million, \$3.1 million and \$3.0 million, respectively. Research and development expenditures funded by corporate or governmental partners were \$418,000 for the fiscal year ended May 25, 2008, \$661,000 for the fiscal year ended May 27, 2007 and \$100,000 for the fiscal year ended May 28, 2006. The Company may continue to seek funds for applied materials research programs from U.S. government agencies as well as from commercial entities. The Company anticipates that it will continue to have significant research and development expenditures in order to maintain its competitive position with a continuing flow of innovative, high-quality products and services. As of May 25, 2008, Landec had 25 employees engaged in research and development with experience in polymer and analytical chemistry, product application, product formulation, mechanical and chemical engineering.

## **Competition**

The Company operates in highly competitive and rapidly evolving fields, and new developments are expected to continue at a rapid pace. Competition from large food packaging and agricultural companies is intense. In addition, the nature of the Company's collaborative arrangements and its technology licensing business may result in its corporate partners and licensees becoming competitors of the Company. Many of these competitors have substantially greater financial and technical resources and production and marketing capabilities than the Company, and many have substantially greater experience in conducting field trials, obtaining regulatory approvals and manufacturing and marketing commercial products. There can be no assurance that these competitors will not succeed in developing alternative technologies and products that are more effective, easier to use or less expensive than those which have been or are being developed by the Company or that would render the Company's technology and products obsolete and non-competitive.

## **Patents and Proprietary Rights**

The Company's success depends in large part on its ability to obtain patents, maintain trade secret protection and operate without infringing on the proprietary rights of third parties. The Company has had 35 U.S. patents issued of which 28 remain active as of May 25, 2008 with expiration dates ranging from 2010 to 2023. The Company's issued patents include claims relating to compositions, devices and use of a class of temperature sensitive polymers that exhibit distinctive properties of permeability, adhesion and viscosity control. There can be no assurance that any of the pending patent applications will be approved, that the Company will develop additional proprietary products that are patentable, that any patents issued to the Company will provide the Company with competitive advantages or will not be challenged by any third parties or that the patents of others will not prevent the commercialization of products incorporating the Company's technology. Furthermore, there can be no assurance that others will not independently develop similar products, duplicate any of the Company's products or design around the Company's patents. Any of the foregoing results could have a material adverse effect on the Company's business, operating results and financial condition.

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

Litigation, which could result in substantial costs to the Company, may also be necessary to enforce any patents issued or licensed to the Company or to determine the scope and validity of third-party proprietary rights. If competitors of the Company prepare and file patent applications in the United States that claim technology also claimed by the Company, the Company may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office to determine priority of invention, which could result in substantial cost to and diversion of effort by the Company, even if the eventual outcome is favorable to the Company. Any such litigation or interference proceeding, regardless of outcome, could be expensive and time consuming and could subject the Company to significant liabilities to third parties, require disputed rights to be licensed from third parties or require the Company to cease using such technology and consequently, could have a material adverse effect on the Company's business, operating results and financial condition.

In addition to patent protection, the Company also relies on trade secrets, proprietary know-how and technological advances which the Company seeks to protect, in part, by confidentiality agreements with its collaborators, employees and consultants. There can be no assurance that these agreements will not be breached, that the Company will have adequate remedies for any breach, or that the Company's trade secrets and proprietary know-how will not otherwise become known or be independently discovered by others.

## **Employees**

As of May 25, 2008, Landec had 118 full-time employees, of whom 54 were dedicated to research, development, manufacturing, quality control and regulatory affairs and 64 were dedicated to sales, marketing and administrative activities. Landec intends to recruit additional personnel in connection with the development, manufacturing and marketing of its products. None of Landec's employees is represented by a union, and Landec believes its relationship with its employees is good.

## **Available Information**

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

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

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

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

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

- the seasonality of our supplies;
- our ability to process produce during critical harvest periods;
- the timing and effects of ripening;



- the degree of perishability;
- the effectiveness of worldwide distribution systems;
- total worldwide industry volumes;
- the seasonality of consumer demand;
- foreign currency fluctuations; and
- foreign importation restrictions and foreign political risks.

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

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

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

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

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

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

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



***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.

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

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

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

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

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

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

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

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

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

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

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

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

For the fiscal year ended May 25 , 2008, approximately 30% 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 fiscal year 2008, sales to our top five customers accounted for approximately 47% of our revenues, with our largest customer, Costco Wholesale Corporation, accounting for approximately 20% 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 Shareholder***

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

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

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





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

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

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

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

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

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

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

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

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

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

None.

**Item 2. Properties**

As of May 25, 2008, the Company owned or leased properties in Menlo Park, Arroyo Grande and Guadalupe, California; West Lebanon and Oxford, Indiana.

These properties are described below:

<u>Location</u>	<u>Business Segment</u>	<u>Ownership</u>	<u>Facilities</u>	<u>Acres of Land</u>	<u>Lease Expiration</u>
Menlo Park, CA	Technology Licensing	Leased	10,400 square feet of office and laboratory space	—	12/31/09
West Lebanon, IN	Technology Licensing	Owned	4,000 square feet of warehouse and manufacturing space	—	—
Oxford, IN	Technology Licensing	Leased	13,400 square feet of laboratory and manufacturing space	—	6/30/09
Guadalupe, CA	Food Products Technology	Owned	142,000 square feet of office space, manufacturing and cold storage	17.7	—
Arroyo Grande, CA	Commodity Trading	Leased	1,100 square feet of office space	—	Month to Month

There are no bank liens encumbering any of the Company's owned land and buildings.

**Item 3. 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 4. Submission of Matters to a Vote of Security Holders**

There were no matters submitted to a vote of security holders during the fourth quarter of the Company's fiscal year ended May 25, 2008.

## PART II

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

#### Market Information

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

<u>Fiscal Year Ended May 25, 2008</u>	<u>High</u>	<u>Low</u>
4 <sup>th</sup> Quarter ending May 25, 2008	\$ 9.94	\$ 7.50
3 <sup>rd</sup> Quarter ending February 24, 2008	\$ 14.00	\$ 8.26
2 <sup>nd</sup> Quarter ending November 25, 2007	\$ 16.75	\$ 11.11
1 <sup>st</sup> Quarter ending August 26, 2007	\$ 14.17	\$ 9.60
<u>Fiscal Year Ended May 27, 2007</u>	<u>High</u>	<u>Low</u>
4 <sup>th</sup> Quarter ending May 27, 2007	\$ 15.13	\$ 12.01
3 <sup>rd</sup> Quarter ending February 25, 2007	\$ 13.80	\$ 9.49
2 <sup>nd</sup> Quarter ending November 26, 2006	\$ 11.32	\$ 9.03
1 <sup>st</sup> Quarter ending August 27, 2006	\$ 11.11	\$ 7.96

#### Holders

There were approximately 78 holders of record of 26,164,653 shares of outstanding Common Stock as of July 18, 2008. Since certain holders are listed under their brokerage firm's names, the actual number of shareholders is higher.

#### Dividends

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

#### Issuer Purchases of Equity Securities

There were no shares repurchased by the Company during the quarter ending on May 25, 2008.

**Item 6. Selected Financial Data**

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

	Year Ended May 25, 2008	Year Ended May 27, 2007	Year Ended May 28, 2006	Year Ended May 29, 2005	Year Ended May 30, 2004
<b>Statement of Operations Data:</b>					
(in thousands)					
<b>Revenues:</b>					
Product sales	\$ 227,550	\$ 201,892	\$ 225,404	\$ 201,020	\$ 185,664
Service revenues	3,640	3,539	3,725	3,704	5,791
License fees	6,231	4,013	2,398	88	88
R&D and royalty revenues	1,106	1,054	426	418	549
<b>Total revenues</b>	<b>238,527</b>	<b>210,498</b>	<b>231,953</b>	<b>205,230</b>	<b>192,092</b>
<b>Cost of revenue:</b>					
Cost of product sales	197,288	175,252	188,904	170,359	158,911
Cost of service revenue	3,011	2,860	3,005	2,899	3,390
<b>Total cost of revenue</b>	<b>200,299</b>	<b>178,112</b>	<b>191,909</b>	<b>173,258</b>	<b>162,301</b>
<b>Gross profit</b>	<b>38,228</b>	<b>32,386</b>	<b>40,044</b>	<b>31,972</b>	<b>29,791</b>
<b>Operating costs and expenses:</b>					
Research and development	3,251	3,074	3,042	2,543	3,452
Selling, general and administrative	19,801	21,616	27,979	23,412	22,284
Income from sale of FCD	—	(22,669)	—	—	—
<b>Total operating costs and expenses</b>	<b>23,052</b>	<b>2,021</b>	<b>31,021</b>	<b>25,955</b>	<b>25,736</b>
<b>Operating profit</b>	<b>15,176</b>	<b>30,365</b>	<b>9,023</b>	<b>6,017</b>	<b>4,055</b>
Interest income	2,219	1,945	633	214	164
Interest expense	(22)	(251)	(452)	(414)	(811)
Minority interest expense	(477)	(412)	(529)	(411)	(537)
Other (expense)/income, net	—	(2)	(24)	(4)	29
<b>Net income before taxes</b>	<b>16,896</b>	<b>31,645</b>	<b>8,651</b>	<b>5,402</b>	<b>2,900</b>
Income tax expense	(3,354)	(2,456)	—	—	—
<b>Net income</b>	<b>\$ 13,542</b>	<b>\$ 29,189</b>	<b>\$ 8,651</b>	<b>\$ 5,402</b>	<b>\$ 2,900</b>
<b>Net income</b>	<b>\$ 13,542</b>	<b>\$ 29,189</b>	<b>\$ 8,651</b>	<b>\$ 5,402</b>	<b>\$ 2,900</b>
Dividends on preferred stock	—	—	—	—	(464)
<b>Net income applicable to common shareholders</b>	<b>\$ 13,542</b>	<b>\$ 29,189</b>	<b>\$ 8,651</b>	<b>\$ 5,402</b>	<b>\$ 2,436</b>
<b>Basic net income per share</b>	<b>\$ 0.52</b>	<b>\$ 1.16</b>	<b>\$ 0.35</b>	<b>\$ 0.23</b>	<b>\$ 0.11</b>
<b>Diluted net income per share</b>	<b>\$ 0.50</b>	<b>\$ 1.07</b>	<b>\$ 0.32</b>	<b>\$ 0.21</b>	<b>\$ 0.12</b>
<b>Shares used in per share computation:</b>					
Basic	26,069	25,260	24,553	23,705	21,396
Diluted	26,935	26,558	25,657	24,614	23,556



<b>Balance Sheet Data:</b>	<b>May 25, 2008</b>	<b>May 27, 2007</b>	<b>May 28, 2006</b>	<b>May 29, 2005</b>	<b>May 30, 2004</b>
<b>(in thousands)</b>					
Cash and cash equivalents	\$ 44,396	\$ 62,556	\$ 15,164	\$ 7,426	\$ 4,966
Total assets	150,589	141,368	119,025	100,075	93,007
Debt	—	—	2,018	3,088	8,996
Retained earnings (deficit)	1,492	(19,332)	(41,239)	(48,890)	(55,292)
Total shareholders' equity	\$ 114,466	\$ 110,228	\$ 85,049	\$ 72,060	\$ 61,549

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

The following discussion should be read in conjunction with the Company's Consolidated Financial Statements contained in Item 8 of this report. Except for the historical information contained herein, the matters discussed in this report are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Potential risks and uncertainties include, without limitation, those mentioned in this report and, in particular, the factors described in Item 1A. "Risk Factors." Landec undertakes no obligation to revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this report.

**Overview**

Since its inception in October 1986, the Company has been engaged in the research and development of its Intelimer technology and related products. The Company has launched four product lines from this core development - QuickCast™ splints and casts, in April 1994, which was subsequently sold to Bissell Healthcare Corporation in August 1997; BreatheWay packaging technology for the fresh-cut and whole produce packaging market, in September 1995; Intelimer Polymer Systems that includes polymer materials for various industrial applications in June 1997 and for personal care applications in November 2003; and Intellicoat coated corn seeds in the Fall of 1999.

Landec has three core businesses - Food Products Technology, Commodity Trading and Technology Licensing. The Food Products Technology segment combines the Company's Intelimer packaging technology with Apio's fresh-cut and whole produce business. The Commodity Trading business is operated through Apio, Inc. and combines Apio's Cal-Ex export company with Apio's domestic buy-sell commodity business that purchases and sells whole fruit and vegetable products to Asia and domestically to Wal-Mart. The 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 Nitta. See "Business - Description of Core Business."

From inception through May 25, 2008, the Company's retained earnings were \$1.5 million. The Company may incur losses in the future. The amount of future net profits, if any, is uncertain and there can be no assurance that the Company will be able to sustain profitability in future years.

**Critical Accounting Policies and Use of Estimates**

*Use of Estimates*

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

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

#### *Notes and Advances Receivable*

Apio has made advances to produce growers for crop and harvesting costs. Typically these advances are paid off within the growing season (less than one year) from crops harvested by the grower and delivered to Apio. Advances not fully paid during the current growing season are converted to interest bearing obligations, evidenced by contracts and notes receivable. These notes receivable and advances are secured by liens on land and/or crops and have terms that range from twelve to sixty months. Notes receivable are periodically reviewed (at least quarterly) for collectibility. A reserve is established for any note or advance deemed to not be fully collectible based upon an estimate of the crop value to be delivered or the fair value of the security for the note or advance. If crop prices or the fair value of the underlying security declines, the Company may be unable to fully recoup its note or advance receivable and the estimated losses would rise in the current period, potentially to the extent of the total note or advance receivable.

#### *Allowance for Doubtful Accounts*

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The allowance for doubtful accounts is based on review of the overall condition of accounts receivable balances and review of significant past due accounts. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Bad debt losses are partially mitigated due to low risks related to the fact that the Company's customers are predominantly large financially sound national and regional retailers.

#### *Inventories*

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

#### *Revenue Recognition*

Revenue from product sales is recognized when there is persuasive evidence that an arrangement exists, title has transferred, the price is fixed and determinable, and collectibility is reasonably assured. Allowances are established for estimated uncollectible amounts, product returns, and discounts. If actual future returns and allowances differ from past experience, additional allowances may be required.

Licensing revenue is recognized in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition (a replacement of SAB 101)*, (SAB 104). Initial license fees are deferred and amortized to revenue over the period of the agreement when a contract exists, the fee is fixed and determinable, and collectibility is reasonably assured. Noncancellable, nonrefundable license fees are recognized over the period of the agreement, including those governing research and development activities and any related supply agreement entered into concurrently with the license when the risk associated with commercialization of a product is non-substantive at the outset of the arrangement.

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

### *Goodwill and Other Intangible Asset Impairment*

The Company is required to evaluate its goodwill and indefinite lived intangible assets for impairment annually in accordance with SFAS No. 142. This evaluation incorporates a variety of estimates including the fair value of the Company's operating segments. If the carrying value of an operating segment's assets exceeds the estimated fair value, the Company is required to record an impairment loss, possibly for the entire carrying balance of goodwill and intangible assets. To date, no impairment losses have been incurred.

### *Income Taxes*

The Company accounts for income taxes in accordance with SFAS No. 109, "*Accounting for Income Taxes*," which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. The Company maintains valuation allowances when it is likely that all or a portion of a deferred tax asset will not be realized. Changes in valuation allowances from period to period are included in the Company's income tax provision in the period of change. In determining whether a valuation allowance is warranted, the Company takes into account such factors as prior earnings history, expected future earnings, unsettled circumstances that, if unfavorably resolved, would adversely affect utilization of a deferred tax asset, carry-back and carry-forward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. At May 25, 2008, the Company had no valuation allowance against deferred tax assets.

In addition to valuation allowances, the Company establishes accruals for certain tax contingencies under FIN 48, "*Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*," when, despite the belief that the Company's tax return positions are fully supported, the Company believes that certain tax positions are likely to be challenged and that the Company's positions may not be fully sustained. The tax-contingency accruals are adjusted in light of changing facts and circumstances, such as the progress of tax audits, case law and emerging legislation. The Company recognizes interest and penalties related to uncertain tax positions as a component of income tax expense. The Company's effective tax rate includes the impact of tax-contingency accruals as considered appropriate by management.

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

### *Stock-Based Compensation*

On May 29, 2006, the Company adopted SFAS 123R, which is a revision of SFAS No. 123 "*Accounting for Stock-Based Compensation*," and supersedes APB No. 25, "*Accounting for Stock Issued to Employees*" ("APB 25"). Among other items, SFAS 123R requires companies to record compensation expense for stock-based awards issued to employees and directors in exchange for services provided. The amount of the compensation expense is based on the estimated fair value of the awards on their grant dates and is recognized over the required service periods. The Company's stock-based awards include stock option grants and restricted stock unit awards (RSUs).

Prior to the adoption of SFAS 123R, the Company applied the intrinsic value method set forth in APB 25 to calculate the compensation expense for stock-based awards. The Company has historically set the exercise price for its stock options equal to the market value on the grant date. As a result, the options had no intrinsic value on their grant dates, and therefore the Company did not record any compensation expense unless the terms of the stock options were subsequently modified. For RSUs, the calculation of compensation expense under APB 25 and SFAS 123R is similar except for the accounting treatment for forfeitures as discussed below.



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. Accordingly, the Company's consolidated financial statements as of May 28, 2006 and for the fiscal year then-ended, were accounted for under the provisions of APB 25.

The estimated fair value for stock options, which determines the Company's calculation of compensation expense, is based on the Black-Scholes pricing model. Upon the adoption of SFAS 123R, the Company changed its method of calculating and recognizing the fair value of stock-based compensation arrangements to the straight-line, single-option method. Compensation expense for all stock option and restricted stock awards granted prior to May 29, 2006 will continue to be recognized using the straight-line, multiple-option method. In addition, SFAS 123R requires the estimation of the expected forfeitures of stock-based awards at the time of grant. As a result, the Company uses historical data to estimate pre-vesting forfeitures and records stock-based compensation expense only for those awards that are expected to vest and revises those estimates in subsequent periods if the actual forfeitures differ from the prior estimates. In the pro-forma information required under SFAS 123R for periods prior to May 29, 2006, the Company accounted for forfeitures as they occurred.

### **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. The Company records the expense for sales and use taxes to general and administrative expenses.

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 were effective for the Company beginning January 1, 2007. The adoption of FIN 48 did not have a significant 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 framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 does not require new fair value measurements but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of information. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. However, on February 12, 2008, the FASB issued FASB Staff ("FSP") FAS No. 157-2 which delays the effective date for all non-financial assets and liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP 157-2 defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within the fiscal years for items within the scope of this FSP. Effective for fiscal year 2009, 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 such adoption 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 adjustments to the fair value of the financial instruments and liabilities an entity elects to carry at fair value will be recognized in earnings. SFAS No. 159 also establishes additional disclosure requirements. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted provided the entity also elects to apply the provisions of SFAS No. 157. The Company is currently evaluating whether it is going to adopt the fair value election under this standard.

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

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.

## Results of Operations

*Fiscal Year Ended May 25, 2008 Compared to Fiscal Year Ended May 27, 2007*

### Revenues (in thousands):

	Fiscal Year ended May 25, 2008	Fiscal Year ended May 27, 2007	Change
Apio Value Added	\$ 167,817	\$ 154,744	8%
Apio Packaging	3,377	1,730	95%
Food Technology	171,194	156,474	9%
Apio Trading	60,414	49,706	22%
Total Apio	231,608	206,180	12%
Technology Licensing	6,919	4,318	60%
Total Revenues	<u>\$ 238,527</u>	<u>\$ 210,498</u>	13%

#### *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 fiscal year ended May 25, 2008 compared to the same period last year is due to increased product offerings, new customers and increased sales to existing customers. Overall value-added sales volume increased 14% during the fiscal year ended May 25, 2008 compared to the same period last year. The increase in value-added sales volumes was higher than the increase in revenues due primarily to the introduction of several new value-added products during 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.

#### *Apio Packaging*

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

The increase in Apio packaging revenues for the fiscal year ended May 25, 2008 compared to the same period last year was primarily due to the increase in the minimum payments received from Chiquita as a result of the amended Chiquita license agreement (see Note 3 to the Consolidated Financial Statements).

#### *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. The export portion of trading revenues for fiscal year 2008 was \$56.2 million or 93% of total trading revenues.

The increase in revenues in Apio's trading business for the fiscal year ended May 25, 2008 compared to the same period last year was primarily due to a 16% 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 fiscal year ended May 25, 2008 compared to the same period last 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):

	<b>Fiscal Year ended May 25, 2008</b>	<b>Fiscal Year ended May 27, 2007</b>	<b>Change</b>
Apio Value Added	\$ 24,615	\$ 23,426	5%
Apio Packaging	3,245	1,639	98%
Food Technology	27,860	25,065	11%
Apio Trading	3,449	3,187	8%
Total Apio	31,309	28,252	11%
Technology Licensing	6,919	4,134	67%
Total Gross Profit	<u>\$ 38,228</u>	<u>\$ 32,386</u>	18%

*General*

There are numerous factors that can influence gross profit including product mix, customer mix, manufacturing costs, volume, sale discounts and charges for excess or obsolete inventory, to name a few. Many of these factors influence or are interrelated with other factors. Therefore, it is difficult to precisely quantify the impact of each item individually. The Company includes in cost of sales all of the costs related to the sale of products in accordance with U.S. generally accepted accounting principles. These costs include the following: raw materials (including produce, seeds 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 fiscal year ended May 25, 2008 compared to the same period last year as outlined in the table above.

*Apio Value-Added*

The increase in gross profit for Apio's value-added specialty packaged vegetable business for the fiscal year ended May 25, 2008 compared to the same period last year was due to increased revenues, partially offset by increased raw material costs, primarily the cost of produce during fiscal year 2008 compared to fiscal year 2007.

*Apio Packaging*

The increase in gross profit for Apio packaging for the fiscal year ended May 25, 2008 compared to the same period last year was primarily due to the increase in minimum payments received from Chiquita as a result of the amended Chiquita license agreement.

*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 gross profit during the fiscal year ended May 25, 2008 compared to the prior fiscal year was not material to the consolidated Landec gross profit.

*Technology Licensing*

The increase in technology licensing gross profit for the fiscal year ended May 25, 2008 compared to the same period of the prior year was primarily due to an increase in gross profit from the Monsanto licensing agreement entered into on December 1, 2006.

**Operating Expenses** (in thousands):

	<i>Fiscal Year ended</i> <i>May 25, 2008</i>	<i>Fiscal Year ended</i> <i>May 27, 2007</i>	<i>Change</i>
<b>Research and Development:</b>			
<i>Apio</i>	\$ 1,251	\$ 1,169	7%
<i>Technology Licensing</i>	2,000	1,905	5%
<i>Total R&amp;D</i>	<u>\$ 3,251</u>	<u>\$ 3,074</u>	6%
<b>Selling, General and Administrative:</b>			
<i>Apio</i>	\$ 13,831	\$ 12,667	9%
<i>Corporate</i>	5,970	8,949	(33%)
<i>Total S,G&amp;A</i>	<u>\$ 19,801</u>	<u>\$ 21,616</u>	(8)%

*Research and Development*

Landec's research and development expenses consist primarily of expenses involved in product development and commercialization initiatives. Research and development efforts at Apio are focused on the Company's proprietary BreatheWay membranes used for packaging produce, with 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 the proprietary Intelimer polymers outside of food.

The increase in research and development expenses for the fiscal year ended May 25, 2008 compared to the same period last year was not material.

*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 fiscal year ended May 25, 2008 compared to the same period last year was primarily due to the fact that selling, general and administrative expenses for Corporate for the fiscal year ended May 27, 2007 included \$3.9 million of net non-recurring expenses, of which \$5.4 million were from expenses incurred by Landec's former direct marketing and sales seed business that was sold to Monsanto in December 2006, partially offset by the recording of net proceeds of \$1.5 million from an insurance settlement during fiscal year 2007. This decrease in selling, general and administrative expenses were partially offset by increased sales and marketing expenses at Apio and increased general and administrative expenses at Corporate primarily related to accounting fees and tax consulting fees.

**Other** (in thousands):

	<i>Fiscal Year ended</i> <i>May 25, 2008</i>	<i>Fiscal Year ended</i> <i>May 27, 2007</i>	<i>Change</i>
<i>Interest Income</i>	\$ 2,219	\$ 1,945	14%
<i>Interest Expense</i>	(22)	(251)	(91)%
<i>Minority Interest Expense</i>	(477)	(412)	16%
<i>Other Expenses</i>	-	(2)	N/M
<i>Total Other Income</i>	<u>\$ 1,720</u>	<u>\$ 1,280</u>	34%
<i>Income taxes</i>	\$ (3,354)	\$ (2,456)	37%

### *Interest Income*

The increase in interest income for the fiscal year ended May 25, 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 fiscal year ended May 25, 2008 compared to the prior year was due to the Company's reduction of debt that was assumed by Monsanto in the sale of FCD to Monsanto on December 1, 2006.

### *Minority Interest Expense*

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

The increase in the minority interest expense in fiscal year 2008 compared to fiscal year 2007 was not material to consolidated Landec net income.

### *Other Expenses*

Other expenses consist of non-operating income and expenses.

### *Income Taxes*

The increase in the income tax expense in fiscal year 2008 compared to fiscal year 2007 is due to an increase in the Company's effective tax rate from 8% last year to 20% this year due to the decrease in the deferred income tax valuation allowance and fully utilizing the Company's net operating loss carryforwards and tax credits during fiscal year 2008.

### *Fiscal Year Ended May 27, 2007 Compared to Fiscal Year Ended May 28, 2006*

#### **Revenues** (in thousands):

	<b>Fiscal Year ended May 27, 2007</b>	<b>Fiscal Year ended May 28, 2006</b>	<b>Change</b>
Apio Value Added	\$ 154,744	\$ 136,141	14%
Apio Packaging	1,730	685	153%
Food Technology	156,474	136,826	14%
Apio Trading	49,706	57,990	(14)%
Total Apio	206,180	194,816	6%
Landec Ag	2,831	34,096	(92)%
Corporate	1,487	3,041	(51)%
Technology Licensing	4,318	37,137	(88)%
Total Revenues	\$ 210,498	\$ 231,953	(9)%

### *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 and from service revenues from Apio Cooling LP.

The increase in Apio's value-added revenues for the fiscal year ended May 27, 2007 compared to the same period last year is due to increased product offerings, increased sales to existing customers and the addition of new customers. Specifically, sales of Apio's value-added 12-ounce specialty packaged retail product line grew 18% and sales of Apio's value-added vegetable tray products also grew 18% during the fiscal year ended May 27, 2007 compared to the same period last year. Overall value-added sales volume increased 15% during the fiscal year ended May 27, 2007 compared to the same period last year.



### *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 Apio packaging revenues for the fiscal year ended May 27, 2007 compared to the same period last year was not material to consolidated Landec revenues.

### *Apio Trading*

Apio trading revenues consist of revenues generated primarily from the purchase and sale of 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. The export portion of trading revenues for fiscal year 2007 was \$46.4 million or 93% of total trading revenues.

The decrease in revenues in Apio's trading business for the fiscal year ended May 27, 2007 compared to the same period last year was primarily due to planned decreases in the domestic buy/sell commodity sales of 57%. Overall trading sales volumes were lower by 27% for the fiscal year ended May 27, 2007 compared to the prior year. In addition, export revenues decreased 8% due to lower sales volumes. The decrease in sales volumes was partially offset by higher average sales prices due to the scarcity of product during certain months of the year.

### *Landec Ag*

Landec Ag revenues have historically consisted of revenues generated from the sale of hybrid seed corn to farmers under the Fielder's Choice Direct brand and from the sale of hybrid seed corn and soybeans under the Heartland Hybrids® brand (these brands, collectively FCD, and the related assets were sold to ASI on December 1, 2006) and from the sale of Intellicoat coated corn and soybean seeds to farmers and seed companies. Prior to the sale of FCD, virtually all of Landec Ag's revenues were generated during the Company's third and fourth quarters. As a result of the technology licensing agreement with Monsanto, Landec Ag license fee revenues will be recognized evenly each quarter for a period of five years.

The decrease in revenues at Landec Ag during the fiscal year ended May 27, 2007 compared to the same period last year was primarily due to the sale of FCD to ASI, partially offset by \$2.7 million in license fee revenues from the Intellicoat license agreement with Monsanto.

### *Corporate*

Corporate revenues consist of revenues generated from partnering with others under research and development agreements and supply agreements and from fees for licensing our proprietary Intelimer technology to others and from the corresponding royalties from these license agreements.

The decrease in Corporate revenues for the fiscal year ended May 27, 2007 compared to the same period of the prior year resulted from certain nonrecurring licensing revenues recorded in the prior year and was not material to consolidated Landec revenues.



**Gross Profit** (in thousands):

	<b>Fiscal Year ended May 27, 2007</b>	<b>Fiscal Year ended May 28, 2006</b>	<b>Change</b>
Apio Value Added	\$ 23,426	\$ 23,022	2%
Apio Packaging	1,639	619	165%
Food Technology	25,065	23,641	6%
Apio Trading	3,187	3,212	(1)%
Total Apio	28,252	26,853	5%
Landec Ag	2,647	10,439	(75)%
Corporate	1,487	2,752	(46)%
Technology Licensing	4,134	13,191	(69)%
<b>Total Gross Profit</b>	<b>\$ 32,386</b>	<b>\$ 40,044</b>	<b>(19)%</b>

*General*

There are numerous factors that can influence gross profit including product mix, customer mix, manufacturing costs, volume, sale discounts and charges for excess or obsolete inventory, to name a few. Many of these factors influence or are interrelated with other factors. Therefore, it is difficult to precisely quantify the impact of each item individually. The Company includes in cost of sales all of the costs related to the sale of products in accordance with U.S. generally accepted accounting principles. These costs include the following: raw materials (including produce, seeds 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 fiscal year ended May 27, 2007 compared to the same period last year as outlined in the table above.

*Apio Value-Added*

The increase in gross profit for Apio's value-added specialty packaged vegetable business for the fiscal year ended May 27, 2007 compared to the same period last year was due to increased revenues, a more profitable mix of products sold and improved operational efficiencies. The more profitable mix of products sold and improved operational efficiencies were almost completely offset by the increased costs associated with weather related shortages of contracted product during several periods of fiscal 2007. These shortages required Apio to procure supplemental product on the open market at costs significantly above contracted prices and resulted in sales volume decreases and labor cost increases.

*Apio Packaging*

The increase in gross profit for Apio Packaging for the fiscal year ended May 27, 2007 compared to the same period last year was primarily due to the revenues received from our licensing agreement with Chiquita and from research and development contracts with other third parties.

*Apio Trading*

Apio's trading business is a buy/sell business that realizes a commission-based margin in the 4-6% range. The decrease in gross profit during the fiscal year ended May 27, 2007 compared to the prior fiscal year was primarily due to the reduction in revenues which was almost completely offset by a shift to higher margin export products from lower margin domestic commodity products.

*Landec Ag*

The decrease in gross profit for Landec Ag for the fiscal year ended May 27, 2007 compared to the same periods last year was due to the sale of FCD to ASI and the consequent loss of product sales and gross profit normally recorded during the second half of our fiscal year. The decrease in Landec Ag gross profit was partially offset by \$2.7 million of gross profit from the Intellicoat license agreement with Monsanto.

## Corporate

The decrease in gross profit for Corporate for the fiscal year ended May 27, 2007 compared to the prior year was primarily due to the Aesthetic Sciences' licensing revenues and gross profit recorded in the prior year.

### Operating Expenses (in thousands):

	<i>Fiscal Year ended</i> <i>May 27, 2007</i>	<i>Fiscal Year ended</i> <i>May 28, 2006</i>	<i>Change</i>
<b>Research and Development:</b>			
<i>Apio</i>	\$ 1,169	\$ 1,108	6%
<i>Landec Ag</i>	266	470	(43)%
<i>Corporate</i>	1,639	1,464	12%
<b>Total R&amp;D</b>	<b>\$ 3,074</b>	<b>\$ 3,042</b>	<b>1%</b>
<b>Selling, General and Administrative:</b>			
<i>Apio</i>	\$ 12,667	\$ 13,633	(7)%
<i>Landec Ag</i>	5,367	9,616	(44)%
<i>Corporate</i>	3,582	4,730	(24)%
<b>Total S,G&amp;A</b>	<b>\$ 21,616</b>	<b>\$ 27,979</b>	<b>(23)%</b>

### Research and Development

Landec's research and development expenses consist primarily of expenses involved in product development and commercialization initiatives. Research and development efforts at Apio are focused on the Company's proprietary BreatheWay membranes used for packaging produce, with recent focus on extending the shelf life of bananas and other shelf-life sensitive vegetables and fruit. At Landec Ag, the research and development efforts are focused on the Company's proprietary Intellicoat coatings for seeds, primarily corn seed. Beginning December 1, 2006, all of the operating costs and expense of Landec Ag are being paid for by Monsanto in accordance with the technology license and supply agreement. At Corporate, the research and development efforts are primarily focused on uses for the proprietary Intelimer polymers outside of food and agriculture.

The increase in research and development expenses for the fiscal year ended May 27, 2007 compared to the same period last year was not material.

### 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 fiscal year ended May 27, 2007 compared to the same period last year was due to (1) the sale of FCD to ASI on December 1, 2006, which eliminated selling, general and administrative expenses associated with agricultural business for the second half of fiscal year 2007, (2) one-time new packaging design and marketing related costs that were incurred at Apio during the first quarter of fiscal year 2006 and (3) the recording of the net proceeds of \$1.5 million from an insurance settlement to Corporate selling, general and administrative expenses during the first six months of fiscal year 2007.

**Other** (in thousands):

	<i>Fiscal Year ended</i> <i>May 27, 2007</i>	<i>Fiscal Year ended</i> <i>May 28, 2006</i>	<i>Change</i>
<i>Interest Income</i>	\$ 1,945	\$ 633	207%
<i>Interest Expense</i>	(251)	(452)	(44)%
<i>Minority Interest Expense</i>	(412)	(529)	(22)%
<i>Other Expenses</i>	(2)	(24)	(92)%
<i>Total Other Income (Exp.)</i>	\$ 1,280	\$ (372)	N/M
<i>Income taxes</i>	\$ (2,456)	\$ 0	N/M

#### *Interest Income*

The increase in interest income for the fiscal year ended May 27, 2007 compared to the prior year was primarily due to the increase in cash available for investing and higher average interest rates on those investments.

#### *Interest Expense*

The decrease in interest expense during the fiscal year ended May 27, 2007 compared to the prior year was due to the Company's reduction of 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 expense in fiscal year 2007 compared to fiscal year 2006 was due to non-recurring gains for Apio Cooling during the first quarter of fiscal year 2006.

#### *Other Expenses*

Other consists of non-operating income and expenses.

#### *Income Taxes*

The increase in the income tax expense in fiscal year 2007 is due to the income realized from the sale of FCD which resulted in the Company recording a tax provision of \$2.5 million for state income taxes and federal AMT.

### **Liquidity and Capital Resources**

As of May 25, 2008, the Company had cash and cash equivalents of \$44.4 million, a net decrease of \$18.2 million from \$62.6 million at May 27, 2007.

#### *Cash Flow from Operating Activities*

Landec generated \$17.5 million of cash flow from operating activities during the fiscal year ended May 25, 2008 compared to using \$2.5 million in operating activities for the fiscal year ended May 27, 2007. The primary sources of cash from operating activities during fiscal year 2008 were from net income of \$13.5 million and non-cash related expenses of \$3.1 million, such as depreciation and stock based compensation.

#### *Cash Flow from Investing Activities*

Net cash used in investing activities for the fiscal year ended May 25, 2008 was \$20.2 million compared to cash provided by investing activities of \$41.9 million for the same period last year due primarily to the sale of FCD. The primary uses of cash from investing activities during fiscal year 2008 were for (1) the purchase of \$4.2 million of property and equipment primarily for the growth of Apio's value-added processing business, (2) the purchase of \$14.6 million of marketable securities and (3) the repurchase of \$1.3 million of subsidiary common stock not owned by the Company.



### Cash Flow from Financing Activities

Net cash used in financing activities for the fiscal year ended May 25, 2008 was \$15.5 million compared to net cash provided by financing activities of \$2.5 million for the same period last year. The primary uses of cash from financing activities during fiscal year 2008 were for the repurchase of all of the outstanding options of Apio not owned by Landec for \$19.5 million which was partially offset by the tax benefit from stock based compensation of \$3.4 million.

### Capital Expenditures

During the fiscal year ended May 25, 2008, Landec purchased property and equipment to support the growth of Apio's value added processing business. These expenditures represented the majority of the \$4.2 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 May 25, 2008, no amounts were outstanding under the revolving line of credit. Apio has been in compliance with all loan covenants during fiscal year 2008.

### Contractual Obligations

The Company's material contractual obligations for the next five years and thereafter as of May 25, 2008, are as follows (in thousands):

Obligation	Due in Fiscal Year Ended May						
	Total	2009	2010	2011	2012	2013	Thereafter
Income taxes	\$ —	—	—	—	—	—	—
Operating Leases	1,465	718	478	258	11	—	—
Licensing Obligation	350	50	100	100	100	—	—
Purchase Commitments	2,213	2,213	—	—	—	—	—
Total	<u>\$ 4,028</u>	<u>\$ 2,981</u>	<u>\$ 578</u>	<u>\$ 358</u>	<u>\$ 111</u>	<u>\$ —</u>	<u>\$ —</u>

The income tax amounts above exclude liabilities under FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes", as we are unable to reasonably estimate the ultimate amount or timing of settlement. See Note 11 in the Notes to Consolidated Financial Statements for further discussion.

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

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

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

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

Not material.

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

See Item 15 of Part IV of this report.

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

Not applicable.

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

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

Our management evaluated, with participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission, and are effective in providing reasonable assurance that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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

There were no changes in our internal controls over financial reporting during the quarter ended May 25, 2008 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management assessed the effectiveness of our internal control over financial reporting as of May 25, 2008. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control - Integrated Framework. Our management has concluded that, as of May 25, 2008, our internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our independent registered public accounting firm, Ernst & Young LLP, have issued an audit report on the effectiveness of our internal control over financial reporting, which is included below.

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

### **REPORT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of Landec Corporation

We have audited Landec Corporation's internal control over financial reporting as of May 25, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Landec Corporation's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Landec Corporation maintained, in all material respects, effective internal control over financial reporting as of May 25, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Landec Corporation and subsidiaries as of May 25, 2008 and May 27, 2007, and the related statements of income, shareholders' equity, and cash flows for each of the three years ended May 25, 2008 of Landec Corporation and our report dated August 7, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Francisco, California  
August 7, 2008

**Item 9B. Other Information**

None



### **PART III**

#### **Item 10.        *Directors and Executive Officers of the Registrant***

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2008 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

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

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2008 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

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

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2008 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

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

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2008 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

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

This information required by this item will be contained in the Registrant's definitive proxy statement which the Registrant will file with the Commission no later than September 22, 2008 (120 days after the Registrant's fiscal year end covered by this Report) and is incorporated herein by reference.

## PART IV

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

(a) 1. Consolidated Financial Statements of Landec Corporation

	<u>Page</u>
Report of Ernst & Young LLP, Independent Registered Public Accounting Firm	44
Consolidated Balance Sheets at May 25, 2008 and May 27, 2007	45
Consolidated Statements of Income for the Years Ended May 25, 2008, May 27, 2007 and May 28, 2006	46
Consolidated Statements of Changes in Shareholders' Equity for the Years Ended May 25, 2008, May 27, 2007 and May 28, 2006	47
Consolidated Statements of Cash Flows for the Years Ended May 25, 2008, May 27, 2007 and May 28, 2006	48
Notes to Consolidated Financial Statements	49
2. All schedules provided for in the applicable accounting regulations of the Securities and Exchange Commission have been omitted since they pertain to items which do not appear in the financial statements of Landec Corporation and its subsidiaries or to items which are not significant or to items as to which the required disclosures have been made elsewhere in the financial statements and supplementary notes and such schedules.	
3. Index of Exhibits	75
The exhibits listed in the accompanying Index of Exhibits are filed or incorporated by reference as part of this report.	

**REPORT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED  
PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders of Landec Corporation

We have audited the accompanying consolidated balance sheets of Landec Corporation and subsidiaries as of May 25, 2008 and May 27, 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years ended May 25, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Landec Corporation and subsidiaries at May 25, 2008 and May 27, 2007, and the consolidated results of their operations and their cash flows for each of the three years ended May 25, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in the Notes to the consolidated financial statements, on May 28, 2007, the Company adopted the provisions of SFAS Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*, and changed its method of recognizing uncertain tax positions. Also, effective May 29, 2006, the Company changed its method of accounting for share-based compensation to conform with SFAS No. 123-R, *Share Based Payments*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Landec Corporation's internal control over financial reporting as of May 25, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 7, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Francisco, California  
August 7, 2008

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

	<u>May 25, 2008</u>	<u>May 27, 2007</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 44,396	\$ 62,556
Marketable securities	14,643	—
Accounts receivable, less allowance for doubtful accounts of \$169 and \$206 at May 25, 2008 and May 27, 2007, respectively	19,460	17,631
Accounts receivable, related party	411	554
Inventories, net	7,329	6,800
Notes and advances receivable	501	282
Deferred taxes	2,180	—
Prepaid expenses and other current assets	1,746	1,316
<b>Total current assets</b>	<b>90,666</b>	<b>89,139</b>
Property and equipment, net	21,306	20,270
Goodwill, net	27,354	21,402
Trademarks, net	8,228	8,228
Notes receivable	—	96
Other assets	3,035	2,233
<b>Total Assets</b>	<b>\$ 150,589</b>	<b>\$ 141,368</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 18,991	\$ 14,163
Related party payables	273	175
Accrued compensation	2,197	3,126
Other accrued liabilities	2,930	1,340
Deferred revenue	3,613	3,491
<b>Total current liabilities</b>	<b>28,004</b>	<b>22,295</b>
Deferred revenue	5,000	7,000
Deferred taxes	1,569	—
Minority interest	1,550	1,845
<b>Total liabilities</b>	<b>36,123</b>	<b>31,140</b>
Commitments and contingencies		
Shareholders' equity:		
Common stock, \$0.001 par value; 50,000,000 shares authorized; 26,156,323 and 25,891,168 shares issued and outstanding at May 25, 2008 and May 27, 2007, respectively	112,974	129,560
Retained earnings (deficit)	1,492	(19,332)
<b>Total shareholders' equity</b>	<b>114,466</b>	<b>110,228</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 150,589</b>	<b>\$ 141,368</b>

*See accompanying notes.*

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

	<u>Year Ended May 25, 2008</u>	<u>Year Ended May 27, 2007</u>	<u>Year Ended May 28, 2006</u>
<b>Statement of Operations Data:</b>			
<b>Revenues:</b>			
Product sales	\$ 227,550	\$ 201,892	\$ 225,404
Services revenue, related party	3,640	3,539	3,725
License fees	6,231	4,013	2,398
Research, development and royalty revenues	1,075	805	162
Royalty revenues, related party	31	249	264
<b>Total revenues</b>	<u>238,527</u>	<u>210,498</u>	<u>231,953</u>
<b>Cost of revenue:</b>			
Cost of product sales	194,868	172,251	184,345
Cost of product sales, related party	2,420	3,001	4,559
Cost of services revenue	3,011	2,860	3,005
<b>Total cost of revenue</b>	<u>200,299</u>	<u>178,112</u>	<u>191,909</u>
<b>Gross profit</b>	<u>38,228</u>	<u>32,386</u>	<u>40,044</u>
<b>Operating costs and expenses:</b>			
Research and development	3,251	3,074	3,042
Selling, general and administrative	19,801	21,616	27,979
Income from sale of FCD (Note 2)	—	(22,669)	—
<b>Total operating costs and expenses</b>	<u>23,052</u>	<u>2,021</u>	<u>31,021</u>
<b>Operating income</b>	<u>15,176</u>	<u>30,365</u>	<u>9,023</u>
Interest income	2,219	1,945	633
Interest expense	(22)	(251)	(452)
Minority interest expense	(477)	(412)	(529)
Other expense, net	—	(2)	(24)
<b>Net income before taxes</b>	<u>16,896</u>	<u>31,645</u>	<u>8,651</u>
Income tax expense	(3,354)	(2,456)	—
<b>Net income</b>	<u>\$ 13,542</u>	<u>\$ 29,189</u>	<u>\$ 8,651</u>
<b>Basic net income per share</b>	<u>\$ 0.52</u>	<u>\$ 1.16</u>	<u>\$ 0.35</u>
<b>Diluted net income per share</b>	<u>\$ 0.50</u>	<u>\$ 1.07</u>	<u>\$ 0.32</u>
<b>Shares used in per share computation:</b>			
Basic	<u>26,069</u>	<u>25,260</u>	<u>24,553</u>
Diluted	<u>26,935</u>	<u>26,558</u>	<u>25,657</u>

*See accompanying notes .*



**LANDEC CORPORATION**  
**CONSOLIDATED STATEMENTS OF CHANGES IN**  
**SHAREHOLDERS' EQUITY**  
(in thousands, except share and per share amounts)

	<u>Common Stock</u>		<u>Retained</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Earnings</u>	<u>Shareholders'</u>
			<u>(Deficit)</u>	<u>Equity</u>
Balance at May 29, 2005	24,086,368	\$ 121,950	\$ (49,890)	\$ 72,060
Issuance of common stock at \$0.86 to \$6.75 per share	678,744	3,378	—	3,378
Issuance of common stock for the net assets of Heartland Hybrids	152,186	960	—	960
Net income and comprehensive income	—	—	8,651	8,651
Balance at May 28, 2006	24,917,298	126,288	(41,239)	85,049
Issuance of common stock at \$1.66 to \$8.86 per share	973,870	2,657	—	2,657
Stock-based compensation	—	615	—	615
Repurchase of subsidiary common stock and options	—	—	(7,282)	(7,282)
Net income and comprehensive income	—	—	29,189	29,189
Balance at May 27, 2007	25,891,168	129,560	(19,332)	110,228
Reclassify repurchase of subsidiary common stock and options	—	(2,502)	7,282	4,780
Issuance of common stock at \$1.89 to \$7.53 per share	255,153	1,120	—	1,120
Issuance of common stock for vested restricted stock units	10,002	—	—	—
Stock-based compensation	—	871	—	871
Tax benefit from stock-based compensation expense	—	3,423	—	3,423
Repurchase of subsidiary common stock and options (Note 5)	—	(19,498)	—	(19,498)
Net income and comprehensive income	—	—	13,542	13,542
Balance at May 25, 2008	<u>26,156,323</u>	<u>\$ 112,974</u>	<u>\$ 1,492</u>	<u>\$ 114,466</u>

*See accompanying notes*

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

	<b>Year Ended May 25, 2008</b>	<b>Year Ended May 27, 2007</b>	<b>Year Ended May 28, 2006</b>
<b>Cash flows from operating activities:</b>			
Net income	\$ 13,542	\$ 29,189	\$ 8,651
Adj. to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	3,204	3,260	3,203
Stock-based compensation expense	871	615	—
Deferred taxes	(611)	—	—
Minority interest	477	412	529
Increase in long-term receivable	(800)	(400)	—
Income from sale of FCD (Note 2)	—	(24,587)	—
Net loss (gain) on disposal of property and equipment	—	43	(120)
Investment in unconsolidated business	—	(481)	(1,311)
Changes in assets and liabilities, net of effects from acquisitions:			
Accounts receivable, net	(1,829)	(273)	(1,883)
Accounts receivable, related party	143	7	(85)
Inventories, net	(529)	(8,733)	(3,123)
Issuance of notes and advances receivable	(2,652)	(2,186)	(1,761)
Collection of notes and advances receivable	2,425	2,228	1,882
Prepaid expenses and other current assets	(430)	(268)	431
Accounts payable	4,828	(2,967)	3,685
Related party accounts payable	98	(358)	(260)
Accrued compensation	(929)	95	1,396
Other accrued liabilities	1,590	(658)	(146)
Deferred revenue	(1,878)	2,600	(223)
Net cash provided by (used in) operating activities	<u>17,520</u>	<u>(2,462)</u>	<u>10,865</u>
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment	(4,240)	(6,782)	(4,746)
Net proceeds from sale of FCD (Note 2)	—	49,441	—
Acquisition of businesses, net of cash acquired and earnout payments	(1,433)	(1,320)	(3,860)
Issuance of notes and advances receivable	(12)	(37)	(425)
Collection of notes and advances receivable	116	638	224
Proceeds from the sale of property and equipment	—	—	1,350
Purchase of marketable securities	(14,643)	—	(991)
Proceeds from maturities of marketable securities	—	—	2,959
Net cash (used in) provided by investing activities	<u>(20,212)</u>	<u>41,940</u>	<u>(5,489)</u>
<b>Cash flows from financing activities:</b>			
Proceeds from sale of common stock	1,120	2,657	3,378
Proceeds from the exercise of subsidiary options	—	66	105
Repurchase of subsidiary options	(19,498)	(7,282)	—
Tax benefit from stock-based compensation expense	3,423	—	—
Net change in other assets	(2)	72	254
Borrowings on lines of credit	—	9,338	14,904



Payments on lines of credit	—	—	(14,904)
Payments on long term debt	—	(1,990)	(1,136)
Payments to minority interest	(511)	(302)	(329)
Net cash (used in) provided by financing activities	<u>(15,468)</u>	<u>2,559</u>	<u>2,272</u>
Net (decrease) increase in cash and cash equivalents	(18,160)	42,037	7,648
Cash and cash equivalents at beginning of year (including FCD)	<u>62,556</u>	<u>20,519</u>	<u>12,871</u>
Cash and cash equivalents at end of year (including FCD)	44,396	62,556	20,519
Less: Cash held in assets held for sale	—	—	(5,355)
Cash and cash equivalents at end of year	<u>\$ 44,396</u>	<u>\$ 62,556</u>	<u>\$ 15,164</u>
Supplemental disclosure of cash flows information:			
Cash paid during the period for interest	<u>\$ 8</u>	<u>\$ 179</u>	<u>\$ 312</u>
Cash paid during the period for income taxes	<u>\$ 850</u>	<u>\$ 1,198</u>	<u>\$ —</u>
Supplemental schedule of noncash operating and investing activities:			
Long-term receivable from Monsanto	<u>\$ 800</u>	<u>\$ 400</u>	<u>\$ —</u>
Preferred stock received from investment in unconsolidated business	<u>\$ —</u>	<u>\$ 481</u>	<u>\$ 1,311</u>
Sale of land and equipment for note receivable	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 380</u>

*See accompanying notes.*

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**Organization**

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

**Basis of Presentation**

**Basis of Consolidation**

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

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

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

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

**Reclassifications**

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

**Summary of Significant Accounting Policies**

**Use of Estimates**

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

## **1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)**

valuation of intangible assets and inventory; the valuation and nature of impairments of investments; and the valuation and recognition of stock-based compensation.

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

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

### **Concentrations of Risk**

Cash and cash equivalents, short-term investments, trade accounts receivable, grower advances and notes receivable are financial instruments that potentially subject the Company to concentrations of credit risk. Corporate policy limits, among other things, the amount of credit exposure to any one issuer and to any one type of investment, other than securities issued or guaranteed by the U.S. government. The Company routinely assesses the financial strength of customers and growers and, as a consequence, believes that trade receivables, grower advances and notes receivable credit risk exposure is limited. Credit losses for bad debt are provided for in the consolidated financial statements through a charge to operations. A valuation allowance is provided for known and anticipated credit losses. The recorded amounts for these financial instruments approximate their fair value.

Several of the raw materials used to manufacture the Company's products are currently purchased from a single source, including some monomers used to synthesize Intelimer® polymers and substrate materials for the production of Intelimer packaging used on a multitude of Apio value-added products.

During the fiscal year ended May 25, 2008, sales to the Company's top five customers accounted for approximately 47% of total revenue, with the top customer, Costco Wholesale Corporation from the Food Products Technology segment, accounting for approximately 20% of total revenues. In addition, approximately 30% of the Company's total revenues were derived from product sales to international customers, none of whom individually accounted for more than 5% of total revenues. As of May 25, 2008, Costco Wholesale Corporation represented approximately 19% of total accounts receivable.

During the fiscal year ended May 27, 2007, sales to the Company's top five customers accounted for approximately 50% of total revenue, with the top customers, Costco Wholesale Corporation and Sam's Club from the Food Products Technology segment, accounting for approximately 21% and 10%, respectively, of total revenues. In addition, approximately 28% of the Company's total revenues were derived from product sales to international customers, none of whom individually accounted for more than 5% of total revenues. As of May 27, 2007, Costco Wholesale Corporation and Sam's Club represented approximately 20% and 11%, respectively, of total accounts receivable.

### **Impairment of Long-Lived Assets**

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Recoverability of assets is measured by comparison of the carrying amount of the asset to the net undiscounted future cash flow expected to be generated from the asset. If the future undiscounted cash flows are not sufficient to recover the carrying value of the assets, the assets' carrying value is adjusted to fair value.

The Company regularly evaluates its long-lived assets for indicators of possible impairment. To date, no impairment has been recorded.

## 1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

### Financial Instruments

The Company's financial instruments are primarily composed of marketable debt securities, commercial-term trade payables and grower advances, and notes receivable, as well as long-term notes receivables and debt instruments. For short-term instruments, the historical carrying amount is a reasonable estimate of fair value. Fair values for long-term financial instruments not readily marketable are estimated based upon discounted future cash flows at prevailing market interest rates. Based on these assumptions, management believes the fair market values of the Company's financial instruments are not materially different from their recorded amounts as of May 25, 2008.

### Allowance for Doubtful Accounts

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments and sales discounts. The allowance for doubtful accounts is based on review of the overall condition of accounts receivable balances and review of significant past due accounts. The allowance for doubtful accounts is based on specific identification of past due amounts and a general reserve for accounts over 90-days past due. The changes in the Company's allowances for doubtful accounts are summarized in the following table (in thousands).

	<u>Balance at beginning of period</u>	<u>Additions charged to costs and expenses</u>	<u>Deductions</u>	<u>Balance at end of period</u>
Year ended May 28, 2006 Allowance for doubtful accounts receivable and notes receivable	\$ 345	\$ 10	\$ (135)	\$ 220
Year ended May 27, 2007 Allowance for doubtful accounts receivable and notes receivable	\$ 220	\$ 64	\$ (78)	\$ 206
Year ended May 25, 2008 Allowance for doubtful accounts receivable and notes receivable	\$ 206	\$ -	\$ (37)	\$ 169

### Revenue Recognition

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

Licensing revenue is recognized in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition (a replacement of SAB 101)*, (SAB 104). Initial license fees are deferred and amortized over the period of the agreement to revenue when a contract exists, the fee is fixed and determinable, and collectibility is reasonably assured. Noncancellable, nonrefundable license fees are recognized over the research and development period of the agreement, as well as the term of any related supply agreement entered into concurrently with the license when the risk associated with commercialization of a product is non-substantive at the outset of the arrangement.

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

## 1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

### Other Accounting Policies and Disclosures

#### Cash, Cash Equivalents and Marketable Securities

The Company records all highly liquid securities with three months or less from date of purchase to maturity as cash equivalents and consists mainly of certificate of deposits, money market funds and U.S. Treasuries. Short-term marketable securities consist of certificates of deposit that are FDIC insured with original maturities of more than three months at the date of purchase and less than one year from the date of the balance sheet. The Company classifies all debt securities with readily determined market values as "available for sale" in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. These investments are classified as marketable securities on the consolidated balance sheet as of May 25, 2008 and are carried at fair market value. Unrealized gains and losses are reported as a component of shareholders' equity and were immaterial in fiscal year 2008. The cost of debt securities is adjusted for amortization of premiums and discounts to maturity. This amortization is recorded to interest income. Realized gains and losses on the sale of available-for-sale securities are also recorded to interest income and were immaterial in fiscal year 2008. The cost of securities sold is based on the specific identification method.

#### Inventories

Inventories are stated at the lower of cost (using the first-in, first-out method) or market. As of May 25, 2008 and May 27, 2007 inventories consisted of (in thousands):

	May 25, 2008	May 27, 2007
Finished goods	\$ 2,949	\$ 2,273
Raw materials	4,380	4,527
Inventories, net	<u>\$ 7,329</u>	<u>\$ 6,800</u>

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

#### Advertising Expense

Prior to the sale of FCD on December 1, 2006, the Company deferred certain costs related to direct-response advertising of Landec Ag's hybrid corn seeds. Such costs were amortized over periods (less than one year) that correspond to the estimated revenue stream of the advertising activity. Advertising expenditures for Landec Ag and Apio that are not direct-response advertisements are expensed as incurred. Advertising expense for the Company for fiscal years 2008, 2007 and 2006 was \$474,000, \$205,000 and \$1.6 million, respectively. The amount of deferred advertising included in prepaid expenses and other current assets at both May 25, 2008 and May 27, 2007 was zero.

## 1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

### Notes and Advances Receivable

Apio has made advances to produce growers for crop and harvesting costs and to the buyer of a fruit processing facility. Notes and advances receivable related to operating activities are for the sourcing of crops for Apio's business and notes and advances receivable related to investing activities are for financing transactions with third parties. Typically operating advances are paid off within the growing season (less than one year) from harvested crops. Advances not fully paid during the current growing season are converted to interest bearing obligations, evidenced by contracts and notes receivable. These notes and advances receivable are secured by perfected liens on land and/or crops and have terms that range from twelve to sixty months. Notes receivable are periodically reviewed (at least quarterly) for collectibility. A reserve is established for any note or advance deemed to not be fully collectible based upon an estimate of the crop value or the fair value of the security for the note or advance.

### Related Party Transactions

Apio provides cooling and distributing services for farms in which the Chairman of Apio (the "Apio Chairman") has a financial interest and purchases produce from those farms. Apio also purchases produce from Beachside Produce LLC for sale to third parties. Beachside Produce is owned by a group of entities and persons that supply produce to Apio including the Apio Chairman. Revenues and the resulting accounts receivable and cost of product sales and the resulting accounts payable are classified as related party items in the accompanying financial statements as of May 25, 2008 and May 27, 2007 and for the years ended May 25, 2008, May 27, 2007 and May 28, 2006.

Apio leases, for approximately \$306,000 on a current annual basis, agricultural land that is owned by the Apio Chairman. Apio, in turn, subleases that land at cost to growers who are obligated to deliver product from that land to Apio for value added products. There is generally no net statement of income impact to Apio as a result of these leasing activities but Apio creates a guaranteed source of supply for the value added business. Apio has loss exposure on the leasing activity to the extent that it is unable to sublease the land. For the years ended May 25, 2008, May 27, 2007 and May 28, 2006, the Company subleased all of the land leased from the Apio Chairman and received sublease income of \$344,000, \$504,000 and \$554,000, respectively, which is substantially equal to the amount the Company paid to lease that land for such periods.

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 fiscal years 2008, 2007 and 2006, the Company recognized revenues of \$1.6 million, \$83,000 and \$103,000, respectively, from the sale of products to Beachside Produce and royalty revenues of \$31,000, \$249,000 and \$264,000, respectively, 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 Consolidated Balance Sheets as of May 25, 2008 and May 27, 2007.

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. The \$227,000 owed to the Apio Chairman as of May 27, 2007, which was included in the minority interest liability at May 27, 2007, was paid in full during fiscal year 2008.

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

### Property and Equipment

Property and equipment are stated at cost. Expenditures for major improvements are capitalized while repairs and maintenance are charged to expense. Depreciation is expensed on a straight-line basis over the estimated useful lives of the respective assets, generally three to thirty years for buildings and leasehold improvements and three to seven years for furniture and fixtures, computers, capitalized software, machinery, equipment and autos. Leasehold improvements are amortized over the lesser of the economic life of the improvement or the life of the lease on a straight-line basis.

## **1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)**

The Company capitalizes software development costs for internal use in accordance with Statement of Position 98-1, " *Accounting for Costs of Computer Software Developed or Obtained for Internal Use* " ("SOP 98-1"). Capitalization of software development costs begins in the application development stage and ends when the asset is placed into service. The Company amortizes such costs using the straight-line basis over estimated useful lives of three to seven years. The Company did not capitalized any software development costs during fiscal years 2008 or 2007.

### **Intangible Assets**

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, *Business Combinations* , and No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

The Company is required under SFAS 142 to review goodwill and indefinite lived intangible assets at least annually. During fiscal year 2008, the Company completed its annual impairment review. The review is performed by grouping the net book value of all long-lived assets for reporting entities, including goodwill and other intangible assets, and comparing this value to the related estimated fair value. The determination of fair value is based on estimated future discounted cash flows related to these long-lived assets. The discount rate used was based on the risks associated with the reporting entities. The determination of fair value was performed by management. The review concluded that the fair value of the reporting entities exceeded the carrying value of their net assets and thus no impairment charge was warranted as of May 25, 2008.

### **Equity Investment in Non-Public Company**

The Company's equity investment of \$1.8 million in a non-public company is carried at cost and adjusted for impairment losses, if any. Since there is no readily available market value information, the Company periodically reviews this investment to determine if any other than temporary declines in value have occurred based on the financial stability and viability of the company. To date, no impairment has been recorded.

### **Deferred Revenue**

Cash received in advance of services performed (principally revenues related to upfront license fees) are recorded as deferred revenue. At May 25, 2008, \$8.3 million has been recognized as a liability for deferred license fee revenues and \$313,000 for advances from customers and on ground lease payments from growers. At May 27, 2007, \$10.3 million has been recognized as a liability for deferred license fee revenues and \$160,000 for advances on ground lease payments from growers.

### **Minority Interest**

In connection with the acquisition of Apio, Landec acquired Apio's 60% general partner interest in Apio Cooling, a California limited partnership. Apio Cooling is included in the consolidated financial statements of Landec for all periods presented. The minority interest balance of \$1.6 million, at May 25, 2008 is comprised of the limited partners' interest in Apio Cooling. The minority interest balance of \$1.8 million at May 27, 2007 is comprised of \$1.6 million of limited partners' interest in Apio Cooling and \$261,000 of third party ownership in Apio which was repurchased by the Company during fiscal year 2008 (see Note 5).

## 1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

### Income Taxes

The Company accounts for income taxes using the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. In evaluating the Company's ability to recover its deferred tax assets, management considered all available positive and negative evidence including the Company's past results of operations and its forecast of future taxable income in the jurisdictions in which Landec has operations. The Company records a valuation allowance to reduce deferred tax assets to the amount that is expected to be realized on a more-likely-than-not basis. A deferred tax expense results from the change in the net deferred tax asset or liability between periods.

Effective May 28, 2007, the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes." 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.

The Company is subject to routine audits by federal and state tax authorities that may result in additional tax liabilities. Several factors drive the calculation of the Company's tax liabilities including, (i) the expiration of various statutes of limitations, (ii) changes in tax law and regulations, (iii) issuance of tax rulings, and (iv) settlements with tax authorities. Changes in any of these factors may result in adjustments in the Company's liabilities, which would impact the Company's reported financial results.

### Per Share Information

Financial Accounting Standards Board issued Statement No. 128, "Earnings Per Share" (SFAS 128) requires the presentation of basic and diluted earnings per share. Basic earnings per share excludes any dilutive effects of options, warrants and convertible securities and is computed using the weighted average number of common share outstanding. Diluted earnings per share reflects the potential dilution if securities or other contracts to issue common stock were exercised or converted into common stock. Diluted common equivalent shares consist of stock options using the treasury stock method.

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

	Fiscal Year Ended May 25, 2008	Fiscal Year Ended May 27, 2007	Fiscal Year Ended May 28, 2006
<b>Numerator:</b>			
Net income	\$ 13,542	\$ 29,189	\$ 8,651
Less: Minority interest in income of subsidiary	—	(778)	(556)
Net income for diluted net income per share	\$ 13,542	\$ 28,411	\$ 8,095
<b>Denominator:</b>			
Weighted average shares for basic net income per share	26,069	25,260	24,553
<b>Effect of dilutive securities:</b>			
Stock options	866	1,298	1,104
Weighted average shares for diluted net income per share	26,935	26,558	25,657
Diluted net income per share	\$ 0.50	\$ 1.07	\$ 0.32

Options to purchase 96,300, 81,030 and 276,313 shares of Common Stock at a weighted average exercise price of \$13.32, \$8.86 and \$6.70 per share were outstanding during fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006, respectively, but were not included in the computation of diluted net income per share because the options' exercise price were greater than the average market price of the Common Stock and, therefore, the effect would be antidilutive.



## 1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

### Cost of Sales

The Company includes in cost of sales all the costs related to the sale of products in accordance with generally accepted accounting principles. These costs include the following: raw materials (including produce, seeds and packaging), direct labor, overhead (including indirect labor, depreciation, and facility related costs) and shipping and shipping related costs.

### Research and Development Expenses

Costs related to both research contracts and Company-funded research is included in research and development expenses. Costs to fulfill research contracts generally approximate the corresponding revenue. Research and development costs are primarily comprised of salaries and related benefits, supplies, travel expenses and corporate allocations.

### Accounting for Stock-Based Compensation

On May 29, 2006, the Company adopted SFAS 123R, which is a revision of SFAS No. 123 *“Accounting for Stock-Based Compensation”* (“SFAS 123”), and supersedes APB No. 25, *“Accounting for Stock Issued to Employees”* (“APB 25”). Among other items, SFAS 123R requires companies to record compensation expense for stock-based awards issued to employees and directors in exchange for services provided. The amount of the compensation expense is based on the estimated fair value of the awards on their grant dates and is recognized over the required service periods. The Company’s stock-based awards include stock option grants and restricted stock unit awards (RSUs).

Prior to the adoption of SFAS 123R, the Company applied the intrinsic value method set forth in APB 25 to calculate the compensation expense for stock-based awards. The Company has historically set the exercise price for its stock options equal to the market value on the grant date. As a result, the options had no intrinsic value on their grant dates, and therefore the Company did not record any compensation expense unless the terms of the stock options were subsequently modified. For RSUs, the calculation of compensation expense under APB 25 and SFAS 123R is similar except for the accounting treatment for forfeitures as discussed below.

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. Accordingly, the Company’s consolidated financial statements as of May 28, 2006 and for the fiscal year then-ended, were accounted for under the provisions of APB 25. During the fiscal year ended May 25, 2008, the Company recognized stock-based compensation expense of \$871,000 which included \$306,000 for restricted stock unit awards and \$565,000 for stock option grants, respectively. During the fiscal year ended May 27, 2007, the Company recognized stock-based compensation expense of \$615,000 which included \$160,000 for restricted stock unit awards and \$455,000 for stock option grants, respectively.

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

	<b>Fiscal Year Ended May 25, 2008</b>	<b>Fiscal Year Ended May 27, 2007</b>
Research and development	\$ 148,000	\$ 82,000
Sales, general and administrative	723,000	533,000
<b>Total stock-based compensation expense</b>	<b>\$ 871,000</b>	<b>\$ 615,000</b>

The estimated fair value for stock options, which determines the Company’s calculation of compensation expense, is based on the Black-Scholes option pricing model. Upon the adoption of SFAS 123R, the Company changed its method of calculating and recognizing the fair value of stock-based compensation arrangements to the straight-line, single-option method. Compensation expense for all stock option and restricted stock awards granted prior to May 29, 2006 will continue to be recognized using the straight-line, multiple-option method. In addition, SFAS 123R requires the estimation of the expected forfeitures of stock-based awards at the time of grant. As a result, the Company uses historical data to estimate pre-vesting forfeitures and records stock-based compensation expense only for those awards that are expected to vest and revises those estimates in subsequent periods if the actual forfeitures differ from the prior estimates. In the pro-forma information required under SFAS 123R for periods prior to May 29, 2006, the Company accounted for forfeitures as they occurred.

## 1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

### Valuation Assumptions

As of May 25, 2008, May 27, 2007 and May 28, 2006, the fair value of stock option grants was estimated using the Black-Scholes option pricing model. The following weighted average assumptions were used:

	Landec Employee Stock Options		
	Fiscal Year Ended	Fiscal Year Ended	Fiscal Year Ended
	May 25, 2008	May 27, 2007	May 28, 2006
Expected life (in years)	4.40	4.27	4.58
Risk-free interest rate	5.02%	5.08%	4.37%
Volatility	0.46	0.51	0.52
Dividend yield	0%	0%	0%

The Black-Scholes option pricing model requires the input of highly subjective assumptions, including the expected stock price volatility. The change in the volatility in the fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006 is a result of basing the volatility on Landec's stock price.

The weighted average estimated fair value of Landec employee stock options granted at grant date market prices during the fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006 was \$5.74, \$4.15 and \$3.36 per share, respectively. No stock options were granted above or below grant date market prices during the fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006. The weighted average estimated fair value of shares granted under the Landec Employee Stock Purchase Plan during the both fiscal years ended May 27, 2007 and May 28, 2006 was \$2.19. The Company terminated the Employee Stock Purchase Plan on June 1, 2006.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the service period of the options using the straight-line method. The Company's pro forma information follows (in thousands except for per share data):

	Year Ended May 28, 2006
Net income – as reported	\$ 8,651
Deduct:	
Stock-based employee expense determined under SFAS 123	(1,160)
Pro forma net income	\$ 7,491
Basic net income per share – as reported	\$ 0.35
Diluted net income per share – as reported	\$ 0.32
Basic pro forma net income per share	\$ 0.31
Diluted pro forma net income per share	\$ 0.27

## 1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)

### 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. The Company records the expense for sales and use taxes to general and administrative expenses.

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 were effective for the Company beginning January 1, 2007. The adoption of FIN 48 did not have a significant 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 framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 does not require new fair value measurements but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of information. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. However, on February 12, 2008, the FASB issued FASB Staff ("FSP") FAS No. 157-2 which delays the effective date for all non-financial assets and liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP 157-2 defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within the fiscal years for items within the scope of this FSP. Effective for fiscal year 2009, the Company will adopt SFAS No. 157, except as it applies to those non-financial assets and non-financial liabilities as noted in FSP157-2. The Company does not expect such adoption 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 adjustments to the fair value of the financial instruments and liabilities an entity elects to carry at fair value will be recognized in earnings. SFAS No. 159 also establishes additional disclosure requirements. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted provided the entity also elects to apply the provisions of SFAS No. 157. The Company is currently evaluating whether it is going to adopt the fair value election under this standard.

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

## **1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies (continued)**

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.

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.

## **2. Sale of Fielder’s Choice Direct and License Agreement**

On December 1, 2006, Landec sold its direct marketing and sales seed company FCD, which included the Fielder’s Choice Direct<sup>®</sup> and Heartland Hybrid<sup>®</sup> brands, to American Seeds, Inc. (ASI), a wholly owned subsidiary of Monsanto Company. The acquisition price for FCD was \$50 million in cash paid at the close. In addition, the Company could have earned up to an additional \$5 million based on FCD results for the twelve months ended May 31, 2007. None of the earn-out was earned. During the 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 with the assistance of an independent appraiser.

## 2. Sale of Fielder's Choice Direct and License Agreement (continued)

The following summarizes sales proceeds allocated to the technology license agreement and the net income from the sale of FCD (in thousands):

Cash received at close	\$	50,000
Fair market value of FCD		40,000
Proceeds allocated to technology license agreement (1)	\$	<u>10,000</u>
Fair market value of FCD	\$	40,000
Less: Cost basis of assets sold net of liabilities assumed		(14,856)
Less: Direct expenses of sale		<u>(557)</u>
Net gain from sale of FCD		24,587
Less: Bonuses paid to employees as a result of the sale		<u>(1,918)</u>
Income from sale of FCD	\$	<u>22,669</u>

(1) Represents a deferred gain at the closing date which will be recognized as revenue over 5 years as described below.

As a result of the sale of FCD, the Company recorded an income tax expense of \$2.5 million in fiscal year 2007 for state income taxes and federal AMT.

On December 1, 2006, Landec also entered into a five-year co-exclusive technology license and polymer supply agreement (“the Agreement”) with Monsanto Company for the use of Landec’s Intellicoat polymer seed coating technology. Under the terms of the Agreement, Monsanto will pay Landec Ag \$2.6 million per year in exchange for (1) a co-exclusive right to use Landec’s Intellicoat temperature-activated seed coating technology worldwide during the license period, (2) the right to be the exclusive global sales and marketing agent for the Intellicoat seed coating technology, and (3) the right to purchase the stock of Landec Ag at any time during the five year term of the Agreement. Monsanto will also fund all operating costs, including all Intellicoat research and development, product development and non-replacement capital costs during the five year agreement period. For the fiscal years 2008 and 2007, Landec recognized \$5.4 million and \$2.7 million, respectively, in revenues from the Agreement.

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

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

## 2. Sale of Fielder's Choice Direct and License Agreement (continued)

In conjunction with the sale of FCD, Landec purchased all of the outstanding common stock and options of Landec Ag not owned by Landec at the fair market value of each share as if all options had been exercised as of December 1, 2006. The fair market value was \$7.4 million which was funded with proceeds from the sale of FCD. After the purchase, Landec Ag became a wholly owned subsidiary of Landec. In accordance with SFAS 123R, this purchase did not result in additional compensation expense to the Company as all of the options purchased were fully vested at the time of the purchase and the consideration paid was equal to the fair value on the date of the purchase. The repurchase of Landec Ag's outstanding common stock and options was recorded to retained earnings as the repurchase occurred after the sale of FCD to Monsanto. At May 25, 2008, \$4.8 million of the \$7.4 million repurchase was reclassified from retained earnings to goodwill in accordance with SFAS 141 to reflect the amount of the repurchase for common stock that was subsequently determined to be a repurchase of minority interest.

Excluding the \$2.7 million in revenues from the Agreement, Landec Ag revenues for the fiscal years 2007 and 2006 were \$131,000 and \$34.1 million, respectively. The net operating losses for Landec Ag, excluding the income from the sale of FCD and the \$2.7 million in license fees from the Agreement, for fiscal year 2007 were \$5.8 million compared to net operating income of \$353,000 in fiscal year 2006.

## 3. License Agreements

On December 23, 2005, Landec entered into an exclusive licensing agreement with Aesthetic Sciences Corporation ("Aesthetic Sciences"), a medical device company. Aesthetic Sciences paid Landec an upfront license fee of \$250,000 for the exclusive rights to use Landec's Intelimer® materials technology for the development of dermal fillers worldwide. Landec will also receive royalties on the sale of products incorporating Landec's technology. In addition, the Company received shares of preferred stock valued at \$1.3 million which represents a 19.9% ownership interest in Aesthetic Sciences as of May 25, 2008. The \$1.3 million is included in other assets in the accompanying Consolidated Balance Sheet. The \$1.6 million of value received under this agreement was recorded as licensing revenue in fiscal year 2006 in the accompanying Consolidated Statements of Operations since Landec has no further obligations under this agreement.

As part of the original agreement with Aesthetic Sciences, Landec was to receive additional shares upon the completion of a specific milestone. On November 22, 2006, that milestone was met and as a result Landec received an additional 800,000 shares of preferred stock valued at \$481,000. The receipt of the additional 800,000 preferred shares did not change Landec's 19.9% ownership interest in Aesthetic Sciences. The \$481,000 is included in other assets in the accompanying Consolidated Balance Sheet and was recorded as licensing revenue during fiscal year 2007 in the accompanying Consolidated Statements of Operations since Landec has no further obligations under this agreement.

On March 14, 2006, Landec entered into an exclusive license and research and development agreement with Air Products and Chemicals, Inc. Landec received an upfront licensing fee of \$800,000 at close and rights to receive up to an additional \$1.6 million of license payments to be paid in quarterly installments of \$200,000 each during years two and three of the agreement for the exclusive rights to use Landec's Intelimer materials technology in specific fields worldwide. The first installment for \$200,000 was received during the fourth quarter of fiscal year 2007. In addition, Landec received at close \$100,000 for technology transfer work that was performed by Landec prior to May 28, 2006. Landec will provide research and development support to Air Products for three years with a mutual option for two additional years. The license fees are being recognized as license revenue over a three year period beginning March 2006. In addition, in accordance with the agreement, Landec will receive approximately 40% of the gross profit generated from the sale of products by Air Products that incorporate Landec's Intelimer materials. In 2008, an amendment was entered into by the Company whereby certain technology applications were re-acquired as well as the elimination of an existing contract claim in order to refine the existing relationship. As a result, the Company recorded a \$600,000 expense to selling, general and administrative expense during the year ended May 25, 2008. The Company recognized \$800,000 in license revenues under this agreement during both fiscal year 2008 and 2007 and recognized \$300,000 during fiscal year 2006. During fiscal years 2008 and 2007 the Company recognized \$528,000 and \$20,000, respectively, for its share of the gross profits realized from the sale of Intelimer-based products by Air Products.

### **3. License Agreements (continued)**

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 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. During fiscal years 2008, 2007 and 2006, the Company recognized \$2.9 million, \$1.0 million and \$515,000, respectively, of gross profits from the Chiquita licensing and supply agreement.

### **4. Insurance Settlement**

On August 25, 2006 the Company received a cash payment of \$1.6 million from the settlement of insurance claims associated with a fire that occurred at its Dock Resins facility in February 2000. The settlement resulted in the Company recording a reduction to selling, general and administrative expenses of \$1.3 million, net of expenses, during the Company’s first quarter of fiscal year 2007. In addition, \$381,000 had been placed in escrow pending the outcome of certain disputed professional fees. In September 2006, the Company resolved the fee dispute and paid professional fees of \$227,000 from the escrow and received the balance of \$154,000 which the Company recorded as a reduction to selling, general and administrative expenses during the second quarter of fiscal year 2007.

### **5. 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 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 \$19.5 million was recorded as a reduction to equity and the repurchase of Apio’s common stock not owned by Landec for \$1.3 million was recorded to goodwill in accordance with SFAS 141.

## 6. Notes and Advances Receivable

	May 25, 2008	May 27, 2007
Notes and advances receivable at May 25, 2008 and May 27, 2007 consisted of the following (in thousands):		
Note receivable due from buyer of fruit processing equipment in annual installments of \$98 plus interest at prime rate plus 1.0%, with final payment due October 20, 2009, secured by purchased assets (2)	\$ 101	\$ 205
Note receivable due from grower in annual installments of \$33 plus interest at prime rate plus 1.0%, with final payment due December 31, 2007, unsecured (1)	—	33
Advances to grower of \$2 per acre to be recovered by withholding proceeds derived from crops. Additional advances of \$60 on January 1 and July 1 to be recovered via weekly deductions of \$2 from proceeds. Agreement ends December 27, 2008 (1)	270	—
Advances to a grower under agricultural subleases in semi-annual installments of \$150, to be repaid at \$12 per week by withholding proceeds from crop produced on this property. Leases expire October 31, 2009 (1)	130	140
Gross notes and advances receivable	501	378
Less allowance for doubtful notes	—	—
Net notes and advances receivable	501	378
Less current portion of notes and advances receivable	(501)	(282)
Non-current portion of notes and advances receivable	\$ 0	\$ 96

(1) Represents notes and advances receivable associated with operating activities.

(2) Represents notes and advances receivable associated with investing activities.

Interest income from interest bearing notes receivable for the fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006 was \$15,000, \$52,000 and \$89,000, respectively.

## 7. Property and Equipment

Property and equipment consists of the following (in thousands):

	Years of Useful Life	May 25, 2008	May 27, 2007
Land and building	15-30	\$ 18,182	\$ 16,783
Leasehold improvements	3-20	775	1,031
Computer, capitalized software, machinery, equipment and auto	3-7	21,973	20,383
Furniture and fixtures	5-7	301	456
Construction in process		217	204
Gross property and equipment		41,448	38,857
Less accumulated depreciation and amortization		(20,142)	(18,587)
Net property and equipment		\$ 21,306	\$ 20,270

Depreciation and amortization expense for the fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006 was \$3.2 million, \$3.3 million and \$3.2 million, respectively. Equipment under capital leases, which is the security for the related lease obligation, at May 25, 2008 and May 27, 2007 was \$104,000 and \$104,000, respectively. The related accumulated amortization for equipment under capital leases at May 25, 2008 and May 27, 2007 was \$99,000 and \$78,000, respectively. Amortization related to capitalized software was \$400,000, \$666,000 and \$661,000, respectively, for fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006. The unamortized computer software costs at May 25, 2008 and May 27, 2007 were \$278,000 and \$594,000, respectively.





## 8. Intangible Assets

Changes in the carrying amount of goodwill for the fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006 by reportable segment, are as follows (in thousands):

	Food Products Technology	Technology Licensing	Total
Balance as of May 29, 2005	\$ 21,233	\$ 4,754	\$ 25,987
Goodwill acquired during the period	—	3,137	3,137
Reclassified to assets held for sale	—	(7,876)	(7,876)
Balance as of May 28, 2006	21,233	15	21,248
Goodwill acquired during the period	169	1,050	1,219
Goodwill sold during the period	—	(1,065)	(1,065)
Balance as of May 27, 2007	21,402	—	21,402
Goodwill acquired/reclassified during the period	1,172	4,780	5,952
Balance as of May 25, 2008	\$ 22,574	\$ 4,780	\$ 27,354

Information regarding Landec's other intangible assets is as follows (in thousands):

	Trademarks	Other	Total
Balance as of May 29, 2005	\$ 11,570	\$ 58	\$ 11,628
Other intangibles acquired	1,700	810	2,510
Reclassified to assets held for sale	(5,042)	(860)	(5,902)
Amortization expense	—	(8)	(8)
Balance as of May 28, 2006	8,228	—	8,228
Amortization expense	—	—	—
Balance as of May 27, 2007	8,228	—	8,228
Amortization expense	—	—	—
Balance as of May 25, 2008	\$ 8,228	\$ —	\$ 8,228

## 9. Shareholders' Equity

Holders of Common Stock are entitled to one vote per share.

### Convertible Preferred Stock

The Company has authorized two million shares of preferred stock, and as of May 25, 2008 has no outstanding preferred stock.

### Common Stock, Stock Purchase Plans and Stock Option Plans

At May 25, 2008, the Company had 2,527,514 common shares reserved for future issuance under Landec stock option plans.

On October 14, 2005, following shareholder approval at the Annual Meeting of Shareholders of the Company, the 2005 Stock Incentive Plan (the "Plan") became effective. The Plan replaced the Company's four then existing equity plans and no shares remain available for grant under these existing plans. Employees (including officers), consultants and directors of the Company and its subsidiaries and affiliates are eligible to participate in the Plan.

## 9. Shareholders' Equity (continued)

The Plan provides for the grant of stock options (both nonstatutory and incentive stock options), stock grants, stock units and stock appreciation rights. Awards under the Plan will be evidenced by an agreement with the Plan participant. Under the Plan, 861,038 shares of the Company's Common Stock ("Shares") were initially available for awards, and as of May 25, 2008, 567,396 shares were available for awards. Under the Plan no recipient may be awarded any of the following during any fiscal year: (i) stock options covering in excess of 500,000 Shares; (ii) stock grants and stock units covering in excess of 250,000 Shares in the aggregate; or (iii) stock appreciation rights covering more than 500,000 Shares. In addition, awards to non-employee directors are discretionary. However, a non-employee director may not be granted awards covering in excess of 30,000 Shares in the aggregate during any fiscal year.

The 1995 Directors' Stock Option Plan (the "Directors' Plan") provided that each person who became a non-employee director of the Company, who had not received a previous grant, be granted a nonstatutory stock option to purchase 20,000 shares of Common Stock on the date on which the optionee first became a non-employee director of the Company. Thereafter, on the date of each annual meeting of the shareholders each non-employee director was granted an additional option to purchase 10,000 shares of Common Stock if, on such date, he or she had served on the Company's Board of Directors for at least six months prior to the date of such annual meeting. The exercise price of the options was the fair market value of the Company's Common Stock on the date the options were granted. Options granted under this plan were exercisable and vested upon grant.

The 1996 Non-Executive Stock Option Plan authorized the Board of Directors to grant non-qualified stock options to employees, including executive officers, and outside consultants of the Company. The exercise price of the options was equal to the fair market value of the Company's Common Stock on the date the options were granted. Options were generally exercisable upon vesting and generally vested ratably over four years and were subject to repurchase if exercised before being vested.

The 1996 Stock Option Plan authorized the Board of Directors to grant stock purchase rights, incentive stock options or non-statutory stock options to Landec executives. The exercise price of the stock purchase rights, incentive stock options and non-statutory stock options could be no less than 100% of the fair market value of Landec's Common Stock on the date the options were granted. Options generally were exercisable upon vesting, generally vested ratably over four years and were subject to repurchase if exercised before being vested.

The New Executive Stock Option Plan authorized the Board of Directors to grant non-statutory stock options to officers of Landec or officers of Apio or Landec Ag whose employment with each of those companies began after October 24, 2000. The exercise price of the non-statutory stock options could be no less than 100% and 85%, for named executives and non-named executives, respectively, of the fair market value of Landec's Common Stock on the date the options were granted. Options generally were exercisable upon vesting, generally vested ratably over four years and were subject to repurchase if exercised before being vested.

*Employee Stock Purchase Plan.* The Company had an employee stock purchase plan which permitted eligible employees to purchase Common Stock, which may not exceed 10% of an employee's compensation, at a price equal to the lower of 85% of the fair market value of the Company's Common Stock at the beginning of the offering period or on the purchase date. The Company issued 869,271 shares under the Employee Stock Purchase Plan prior to it being terminated on June 1, 2006.

## 9. Shareholders' Equity (continued)

Activity under all Landec Stock Option Plans is as follows:

### Stock-Based Compensation Activity

	Restricted Stock Outstanding			Stock Options Outstanding	
	RSU's and Options Available for Grant	Number of Restricted Shares	Weighted Average Grant Date Fair Value	Number of Stock Options	Weighted Average Exercise Price (Fair Value)
Balance at May 29, 2005	941,038	—	—	4,122,496	\$ 5.08
Additional shares reserved	861,038	—	—	—	—
Granted	(83,333)	833	\$ 7.53	82,500	\$ 6.68
Exercised	—	—	—	(1,027,718)	\$ 5.83
Forfeited	59,762	—	—	(59,762)	\$ 6.36
Terminated plans	(920,800)	—	—	—	—
Balance at May 28, 2006	857,705	833	\$ 7.53	3,117,516	\$ 4.85
Granted	(153,335)	38,335	\$ 8.86	115,000	\$ 8.86
Exercised	—	—	—	(1,163,234)	\$ 4.72
Forfeited	8,778	(833)	\$ 7.53	(7,945)	\$ 4.93
Plan shares expired	(6,417)	—	—	—	—
Balance at May 27, 2007	706,731	38,335	\$ 8.86	2,061,337	\$ 5.14
Granted	(139,335)	34,835	\$ 13.32	104,500	\$ 13.32
Awarded/Exercised	—	(10,002)	\$ 8.86	(267,148)	\$ 4.57
Forfeited	—	—	—	(1,739)	\$ 3.80
Balance at May 25, 2008	567,396	63,168	\$ 11.32	1,896,950	\$ 5.68

Included in exercises for fiscal years 2008 and 2007 are 11,995 and 207,112 options, respectively, that were exercised through a net share settlement transaction (no cash) to pay for the exercise price of the options and the related taxes due on the exercise.

The following table summarizes information concerning stock options outstanding and exercisable at May 25, 2008 :

Range of Exercise Prices	Options Outstanding			Options Exercisable			
	Number of Shares Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Shares Exercisable	Weighted Average Exercise Price	Aggregate Intrinsic Value
\$ 1.660 - \$3.180	226,013	4.06	\$ 2.91	\$ 1,159,447	226,013	\$ 2.91	\$ 1,159,447
\$ 3.250 - \$3.375	266,597	2.61	\$ 3.37	\$ 1,245,008	266,597	\$ 3.37	\$ 1,245,008
\$ 3.400 - \$3.700	206,146	2.21	\$ 3.47	\$ 942,087	206,146	\$ 3.47	\$ 942,087
\$ 3.750 - \$6.125	234,694	2.45	\$ 5.07	\$ 697,041	232,506	\$ 5.06	\$ 692,868
\$ 6.130 - \$6.130	262,000	3.98	\$ 6.13	\$ 500,420	224,500	\$ 6.13	\$ 428,795
\$ 6.563 - \$6.750	300,000	3.70	\$ 6.68	\$ 408,000	300,000	\$ 6.68	\$ 408,000
\$ 6.790 - \$8.860	297,000	5.94	\$ 7.77	\$ 80,190	266,298	\$ 7.64	\$ 90,519
\$ 13.32 - \$13.32	104,500	6.09	\$ 13.32	\$ —	39,718	\$ 13.32	\$ —
\$ 1.660 - \$13.32	1,896,950	3.79	\$ 5.68	\$ 5,032,193	1,761,778	\$ 5.33	\$ 4,966,724

At May 25, 2008 and May 27, 2007 options to purchase 1,761,778 and 1,920,424 shares of Landec's Common Stock were vested, respectively. No options have been exercised prior to being vested.



## 9. Shareholders' Equity (continued)

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company's closing stock price of \$8.04 on May 23, 2008, which would have been received by holders of stock options had all holders of stock options exercised their stock options that were in-the-money as of that date. The total number of in-the-money stock options exercisable as of May 25, 2008, was approximately 1.6 million shares. The aggregate intrinsic value of stock options exercised during the fiscal year 2008 was \$1.8 million.

### Shares Subject to Vesting

The following table summarizes the activity relating to unvested stock option grants and RSUs during the fiscal year ended May 25, 2008:

	Stock Options		Restricted Stock	
	Shares	Weighted Average Fair Value	Shares	Weighted Average Fair Value
Unvested at May 27, 2007	140,913	\$ 3.70	38,335	\$ 8.32
Granted	104,500	\$ 5.74	34,835	\$ 13.32
Vested/Awarded	(108,502)	\$ 4.49	(10,002)	\$ 6.79
Forfeited	(1,739)	\$ 3.80	—	—
Unvested at May 25, 2008	135,172	\$ 4.73	63,168	\$ 11.32

As of May 25, 2008, there was \$875,000 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 1.24 years.

As of May 25, 2008 the Company had reserved 2.5 million shares of common stock for future issuance under its current and former stock plans.

*Repurchase of Landec Ag Common Stock and Options.* The Company has reclassified \$4.8 million and \$2.5 million from retained earnings to goodwill and common stock, respectively, to reflect the amount of the repurchase of Landec Ag's common stock and options. The reclassification had no impact on operations for the year ended May 25, 2008.

*Apio Stock Plan.* In connection with the acquisition of Apio, the Board of Directors of Landec authorized the establishment of the 1999 Apio Stock Option Plan ("1999 Plan"). Under the 1999 Plan, the Board of Directors of Apio could grant incentive stock options or non-statutory stock options to employees and outside consultants. The exercise price of the incentive stock options and non-statutory stock options could be no less than 100% and 85%, respectively, of the fair market value of Apio's common stock as determined by Apio's Board of Directors. Five million shares were authorized to be issued under this plan. Options were exercisable upon vesting and generally vested ratably over four years and were subject to repurchase if exercised before being vested. As of May 25, 2008, there were no options outstanding under the 1999 Plan, the 1999 Plan was terminated on August 7, 2007.

In May 2000, the 1999 Plan was terminated. All existing grants remain outstanding, and no future grants will be made from the plan. Concurrently, the 2000 Apio Stock Option Plan ("2000 Plan") was authorized by Apio's Board of Directors, which authorized the issuance of two million shares under the same terms and conditions as the 1999 Plan. As of May 25, 2008, there were no options outstanding under the 2000 Plan, the 2000 Plan was terminated on August 7, 2007. As discussed in Note 5, the Company repurchased all of the outstanding common stock and options of Apio not owned by Landec on August 7, 2007.

## 9. Shareholders' Equity (continued)

The following table summarizes activity under the Apio Stock Option Plan.

	Options Available	Outstanding Options	
		Number of Shares	Weighted Average Exercise Price
Balance at May 29, 2005	1,622,929	2,327,322	\$ 2.10
Options exercised	—	(50,158)	\$ 2.10
Options forfeited	8,469	(8,469)	\$ 2.10
Balance at May 28, 2006	1,631,398	2,268,695	\$ 2.10
Options exercised	—	(24,500)	\$ 2.10
Options forfeited	28,695	(28,695)	\$ 2.10
Balance at May 27, 2007	1,660,093	2,215,500	\$ 2.10
Plan shares expired	(1,660,093)	—	—
Repurchased by Landec	—	(2,215,500)	\$ 10.77
Balance at May 25, 2008	—	—	—

## 10. Debt

### Revolving 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 May 25, 2008, no amounts were outstanding under the revolving line of credit. Apio has been in compliance with all loan covenants during fiscal year 2008.

## 11. Income Taxes

The provision for income taxes consisted of the following (in thousands):

	Year ended May 25, 2008	Year ended May 27, 2007	Year ended May 28, 2006
<b>Current:</b>			
Federal	\$ 1,557	\$ 623	\$ 8
State	2,408	1,833	3
<b>Total</b>	<b>3,965</b>	<b>2,456</b>	<b>11</b>
<b>Deferred:</b>			
Federal	233	—	—
State	(844)	—	—
<b>Total</b>	<b>(611)</b>	<b>—</b>	<b>—</b>
<b>Income tax expense</b>	<b>\$ 3,354</b>	<b>\$ 2,456</b>	<b>\$ 11</b>

For fiscal year 2006 the income tax expense is included in other expense in the accompanying Consolidated Statements of Income as the amount was not material.

The actual provision for income taxes differs from the statutory U.S. federal income tax rate as follows (in thousands):

	Year Ended May 25, 2008	Year Ended May 27, 2007	Year Ended May 28, 2006
Provision at U.S. statutory rate (1)	\$ 5,914	\$ 11,076	\$ 2,949
State income taxes, net of federal benefit	1,152	1,818	506
Change in valuation allowance	(3,647)	(10,026)	(3,788)
Tax credit carryforwards	(510)	(78)	375
Other	445	(334)	(31)
<b>Total</b>	<b>\$ 3,354</b>	<b>\$ 2,456</b>	<b>\$ 11</b>

(1) Statutory rate was 35% for fiscal years 2008 and 2007 and 34% for fiscal year 2006.

Significant components of deferred tax assets and liabilities consisted of the following (in thousands):

	May 25, 2008	May 27, 2007
<b>Deferred tax assets:</b>		
Net operating loss carryforwards	\$ —	\$ 2,385
Research and AMT credit carryforwards	620	2,496
Accruals and reserves, not currently deductible for tax	3,912	1,460
Stock-based compensation	361	193
Capitalized research and development	196	38
<b>Gross deferred tax assets</b>	<b>5,089</b>	<b>6,572</b>
Less: valuation allowance	—	(2,374)
<b>Deferred tax assets</b>	<b>5,089</b>	<b>4,198</b>
<b>Deferred tax liabilities:</b>		
Depreciation and amortization	(53)	(611)
Goodwill and other indefinite life intangibles	(4,425)	(3,587)
<b>Deferred tax liabilities</b>	<b>(4,478)</b>	<b>(4,198)</b>
<b>Net deferred tax assets</b>	<b>\$ 611</b>	<b>\$ —</b>





## 11. Income Taxes (continued)

Valuation allowances are reviewed each period on a tax jurisdiction by jurisdiction basis to analyze whether there is sufficient positive or negative evidence to support a change in judgment about the realizability of the related deferred tax assets. During the second quarter of the year ended May 25, 2008, the Company released the valuation allowance on the net deferred tax assets, primarily as a result of achieving sustained profitability from continuing operations.

As of May 25, 2008, the Company had federal and state net operating loss carryforwards of approximately \$24.6 million and \$5.5 million, respectively. These losses expire in different periods through 2028, if not utilized. Such net operating losses consist of excess tax benefits from employee stock options exercises and have not been recorded in the Company's deferred tax assets in accordance with FAS 123 (R). The Company will record a credit to additional paid in capital as and when such excess tax benefits are ultimately realized.

The Company also had federal and state tax credit carryforwards of approximately \$1.8 million and \$1.5 million, respectively. The research and development tax credit carryforwards expire in different periods through 2028 for federal purposes and have an unlimited carryforward period for state purposes. Certain tax credit carryovers are attributable to excess tax benefits from employee stock option exercises and have not been recorded in the Company's deferred tax assets in accordance with FAS 123(R). The Company will record a credit to additional paid in capital as and when such excess tax benefits are ultimately realized.

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.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance at May 27, 2007	\$	277
Additions based on tax positions related to the current year		86
Additions based on tax positions related to the prior year		315
Settlements		—
Reduction for lapse of statute of limitations		—
Balance at May 25, 2008	\$	<u>678</u>

As of May 25, 2008, the total amount of net unrecognized tax benefits is \$678,000, of which, \$599,000, if recognized, would affect the effective tax rate. The Company accrues interest and penalties related to unrecognized tax benefits in its provision for income taxes. Given the Company's historical net operating loss position, the total amount of penalties and interest is not material as of May 25, 2008. Additionally, the Company does not expect a material changes in its unrecognized tax benefits within the next 12 months.

Due to tax attribute carryforwards, the Company is subject to examination for tax years 1992 forward for U.S. tax purposes. The Company was also subject to examination in various state jurisdictions for tax years 1996 forward, none of which were individually material.

## 12. Commitments and Contingencies

### Operating Leases

Landec leases facilities and equipment under operating lease agreements with various terms and conditions, which expire at various dates through 2012. The approximate future minimum lease payments under these operating leases, excluding land leases, at May 25, 2008 are as follows (in thousands):

	<u>Amount</u>
FY2009	\$ 718
FY2010	478
FY2011	258
FY2012	11
FY2013	—
	<u>\$ 1,465</u>

Rent expense for operating leases, including month to month arrangements was \$1.5 million for the fiscal year ended May 25, 2008, \$1.4 million for the fiscal year ended May 27, 2007 and \$1.4 million for the fiscal year ended May 28, 2006.

### Land Leases

Landec, through its Apio subsidiary, also leases farmland under various non-cancelable leases expiring through October 2009. Landec subleases substantially all of the farmland to growers on an annual basis. The subleases are generally non-cancelable and expire through October 2009. The approximate future minimum leases and sublease amounts receivable under farmland leases at May 25, 2008 are \$435,000 through fiscal year 2010.

Rent income for land leases net of sublease rents, including month to month arrangements was \$0 for the fiscal year ended May 25, 2008 and \$0 for the fiscal year ended May 27, 2007. Rent expense for land leases net of sublease rents, including month to month arrangements was \$25,000 for the fiscal year ended May 28, 2006.

### Employment Agreements

Landec has entered into employment agreements with certain key employees. These agreements provide for these employees to receive incentive bonuses based on the financial performance of certain divisions in addition to their annual base salaries. The accrued incentive bonuses amounted to \$259,000 at May 25, 2008 and \$631,000 at May 27, 2007.

### Licensing Agreement

In fiscal year 2001, the Company entered into an agreement for the exclusive worldwide rights to market grapes under certain brand names. Under the terms of the amended agreement (amended in fiscal year 2004), the Company is obligated to make annual payments of \$100,000 for fiscal years 2009 through 2012.

### Purchase Commitments

At May 25, 2008, the Company was committed to purchase \$2.2 million of produce during fiscal year 2009 in accordance with contractual terms. Payments of \$3.3 million were made in fiscal year 2008 under these arrangements.

### **13. Employee Savings and Investment Plans**

The Company sponsors a 401(k) plan which is available to substantially all of the Company's employees.

Landec's Corporate Plan, which is available to all Landec employees ("Landec Plan"), allows participants to contribute from 1% to 50% of their salaries, up to the Internal Revenue Service (IRS) limitation into designated investment funds. Beginning in fiscal year 2001, the Company amended the plan so that it contributes an amount equal to 50% of the participants' contribution up to 3% of the participants' salary. In May 2003, the Company again amended the plan to make the Company's matching contribution to the plan on behalf of participants voluntary, and to make employees participation in the plan voluntary. In June 2006, the Company again amended the plan to increase the company match from 50% on the first 6% contributed by an employee to 67% on the first 6% contributed. Participants are at all times fully vested in their contributions. The Company's contribution vests over a four-year period at a rate of 25% per year. The Company retains the right, by action of the Board of Directors, to amend, modify, or terminate the plan. For the fiscal years ended May 25, 2008, May 27, 2007 and May 28, 2006, the Company contributed \$352,000, \$401,000 and \$335,000, respectively, to the Landec Plan.

## 14. Business Segment Reporting

Landec operates in three business segments: the Food Products Technology segment, the Commodity Trading segment and the Technology Licensing segment. The Food Products Technology segment markets and packs specialty packaged whole and fresh-cut vegetables that incorporate the BreatheWay specialty packaging for the retail grocery, club store and food services industry. In addition, the Food Products Technology segment sells BreatheWay packaging to partners for non-vegetable products. The Commodity Trading segment consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia and domestically to Wal-Mart. The Technology Licensing segment licenses Landec's patented Intellicoat seed coatings to the farming industry and licenses the Company's Intelimer polymers for personal care products and other industrial products. Corporate includes corporate general and administrative expenses, non Food Products Technology interest income and Company-wide income tax expenses. All of the assets of the Company are located within the United States of America. Prior to fiscal year 2008, Landec's operating segments were Food Products Technology and Agricultural Seed Technology. At fiscal year end 2008, the Company reexamined its segment reporting. As a result, the Company has eliminated the Agricultural Seed Technology segment and has established the Commodity Trading and the Technology Licensing segments. As a result, the segment information for fiscal years 2007 and 2006 has been reclassified to conform with the current year classification. Included in the Technology Licensing segment for fiscal years 2007 and 2006 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. Corporate amounts include corporate general and administrative expenses, non Food Products Technology interest income and Company-wide income taxes. The Company's international sales are primarily to Canada, Taiwan, Indonesia, and Japan. Operations and identifiable assets by business segment consisted of the following (in thousands):

Fiscal Year Ended May 25, 2008	Food Products Technology	Commodity Trading	Technology Licensing	Corporate	TOTAL
Net sales	\$ 171,194	\$ 60,414	\$ 6,919	\$ —	\$ 238,527
International sales	\$ 15,703	\$ 56,191	\$ —	\$ —	\$ 71,894
Gross profit	\$ 27,860	\$ 3,449	\$ 6,919	\$ —	\$ 38,228
Net income (loss)	\$ 14,844	\$ 1,406	\$ 4,919	\$ (7,627)	\$ 13,542
Identifiable assets	\$ 82,577	\$ 16,128	\$ 11,011	\$ 40,873	\$ 150,589
Depreciation and amortization	\$ 2,970	\$ 20	\$ 214	\$ —	\$ 3,204
Capital expenditures	\$ 4,051	\$ —	\$ 189	\$ —	\$ 4,240
Interest income	\$ 522	\$ —	\$ —	\$ 1,697	\$ 2,219
Interest expense	\$ 22	\$ —	\$ —	\$ —	\$ 22
Income tax expense	\$ —	\$ —	\$ —	\$ 3,354	\$ 3,354
<hr/>					
Fiscal Year Ended May 27, 2007					
Net sales	\$ 156,474	\$ 49,706	\$ 4,318	\$ —	\$ 210,498
International sales	\$ 12,406	\$ 46,406	\$ —	\$ —	\$ 58,812
Gross profit	\$ 25,065	\$ 3,187	\$ 4,134	\$ —	\$ 32,386
Net income (loss)	\$ 13,159	\$ 1,518	\$ 19,254	\$ (4,742)	\$ 29,189
Identifiable assets	\$ 81,769	\$ 12,216	\$ 3,776	\$ 43,607	\$ 141,368
Depreciation and amortization	\$ 2,665	\$ 19	\$ 576	\$ —	\$ 3,260
Capital expenditures	\$ 6,259	\$ 18	\$ 505	\$ —	\$ 6,782
Interest income	\$ 751	\$ —	\$ —	\$ 1,194	\$ 1,945
Interest expense	\$ 80	\$ —	\$ 171	\$ —	\$ 251
Income tax expense	\$ —	\$ —	\$ —	\$ 2,456	\$ 2,456
<hr/>					
Fiscal Year Ended May 28, 2006					
Net sales	\$ 136,826	\$ 57,990	\$ 37,137	\$ —	\$ 231,953
International sales	\$ 5,689	\$ 50,337	\$ —	\$ —	\$ 56,026
Gross profit	\$ 23,641	\$ 3,212	\$ 13,191	\$ —	\$ 40,044
Net income (loss)	\$ 10,306	\$ 1,416	\$ 1,389	\$ (4,460)	\$ 8,651
Identifiable assets	\$ 73,679	\$ 9,852	\$ 29,660	\$ 5,834	\$ 119,025
Depreciation and amortization	\$ 2,553	\$ 19	\$ 631	\$ —	\$ 3,203
Capital expenditures	\$ 4,263	\$ —	\$ 483	\$ —	\$ 4,746
Interest income	\$ 502	\$ —	\$ —	\$ 131	\$ 633
Interest expense	\$ 300	\$ —	\$ 152	\$ —	\$ 452

Income tax expense

\$ — \$ — \$ — \$ — \$ —

**15. Quarterly Consolidated Financial Information (unaudited)**

The following is a summary of the unaudited quarterly results of operations for fiscal years 2008, 2007 and 2006 (in thousands, except for per share amounts):

FY 2008	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	FY 2008
Revenues	\$ 62,659	\$ 58,961	\$ 59,607	\$ 57,300	\$ 238,527
Gross profit	\$ 8,974	\$ 8,857	\$ 10,746	\$ 9,651	\$ 38,228
Net income	\$ 3,077	\$ 3,125	\$ 3,966	\$ 3,374	\$ 13,542
Net income per basic share	\$ 0.12	\$ 0.12	\$ 0.15	\$ 0.13	\$ 0.52
Net income per diluted share	\$ 0.11	\$ 0.12	\$ 0.15	\$ 0.13	\$ 0.50

FY 2007	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	FY 2007
Revenues	\$ 51,147	\$ 55,194	\$ 52,956	\$ 51,201	\$ 210,498
Gross profit	\$ 5,556	\$ 8,276	\$ 9,091	\$ 9,463	\$ 32,386
Net income	\$ 14	\$ 108	\$ 24,644	\$ 4,423	\$ 29,189
Net income per basic share	\$ 0.00	\$ 0.00	\$ 0.97	\$ 0.17	\$ 1.16
Net income per diluted share	\$ 0.00	\$ 0.00	\$ 0.92	\$ 0.16	\$ 1.07

FY 2006	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	FY 2006
Revenues	\$ 49,705	\$ 53,712	\$ 57,249	\$ 71,287	\$ 231,953
Gross profit	\$ 6,590	\$ 7,089	\$ 11,415	\$ 14,950	\$ 40,044
Net (loss) income	\$ (521)	\$ (1,037)	\$ 3,514	\$ 6,695	\$ 8,651
Net (loss)/income per basic share	\$ (0.02)	\$ (0.04)	\$ 0.14	\$ 0.27	\$ 0.35
Net (loss)/income per diluted share	\$ (0.02)	\$ (0.04)	\$ 0.13	\$ 0.24	\$ 0.32

(b) Index of Exhibits.

<b>Exhibit Number:</b>	<b>Exhibit Title</b>
2.1	Purchase Agreement between the Registrant and Apio Fresh LLC and the Growers listed therein, dated as of July 3, 2003, incorporated herein by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K dated July 3, 2003.
2.2	Stock Purchase Agreement between The Lubrizol Corporation and the Registrant dated as of October 24, 2002, incorporated herein by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K dated October 24, 2002.
2.3	Purchase Agreement between the Registrant and Apio Fresh LLC and the Growers listed therein, dated as of July 3, 2003, incorporated herein by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K dated July 3, 2003.
3.1	Amended and Restated Bylaws of Registrant, incorporated herein by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K dated December 17, 2007.
3.2	Ninth Amended and Restated Articles of Incorporation of Registrant, incorporated herein by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-1 (File No. 33-80723) declared effective on February 12, 1996.
3.3	Certificate of Determination of Series A Preferred Stock, incorporated herein by reference to Exhibit 3.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 31, 1999.
3.4	Certificate of Determination of Series B Preferred Stock, incorporated herein by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K dated October 25, 2001.
10.1	Form of Indemnification Agreement, incorporated herein by reference to Exhibit 10.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended May 29, 2005 .
10.2*	Form of Option Agreement for 1995 Directors' Stock Option Plan, incorporated herein by reference to Exhibit 10.4 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 31, 1996.
10.3	Industrial Real Estate Lease dated March 1, 1993 between the Registrant and Wayne R. Brown & Bibbits Brown, Trustees of the Wayne R. Brown & Bibbits Brown Living Trust dated December 30, 1987, incorporated by reference to Exhibit 10.6 to the Registrant's Registration Statement on Form S-1 (File No. 33-80723) declared effective on February 12, 1996.
10.4*	Form of Option Agreement for the 1996 Non-Executive Stock Option Plan, as amended, incorporated herein by reference to Exhibit 10.16 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 31, 1996.
10.5*	1996 Amended and Restated Stock Option Plan, incorporated herein by reference to Exhibit 10.17 to the Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended April 29, 2001.
10.6*	Form of Option Agreement for 1996 Amended and Restated Stock Option Plan, incorporated herein by reference to Exhibit 10.17 to the Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 1997.



**Exhibit  
Number:**

**Exhibit Title**

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- 10.7\* New Executive Stock Option Plan, incorporated herein by reference to Exhibit 10.30 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 29, 2000.
- 10.8\* 1996 Non-Executive Stock Option Plan, as amended, incorporated herein by reference to Exhibit 10.35 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 28, 2001.
- 10.9\* Employment Agreement between the Registrant and Gary T. Steele effective as of January 1, 2006, incorporated herein by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K dated December 15, 2005.
- 10.10 Supply Agreement between the Registrant and Apio Fresh LLC and the Growers listed therein, dated as of July 3, 2003, incorporated herein by reference to Exhibit 2.3 to the Registrant's Current Report on Form 8-K dated July 3, 2003.
- 10.11\* 1995 Directors' Stock Option Plan, as amended, incorporated herein by reference to Exhibit 10.53 to the Registrant's Annual Report on Form 10-Q for the fiscal quarter ended May 25, 2003.
- 10.12 Amended and Restated Credit Agreement by and among Apio, Inc. as Borrower, and Wells Fargo Bank, National Association, dated as of November 1, 2005, incorporated herein by reference to Exhibit 10.57 to the Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended November 27, 2005.
- 10.13# License and research and development agreement between the Registrant and Air Products and Chemicals, Inc. dated March 14, 2006, incorporated herein by reference to Exhibit 10.63 to the Registrant's Annual Report on Form 10-K for the fiscal year ended May 28, 2006.
- 10.14\* 2005 Stock Incentive Plan, incorporated herein by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K dated October 14, 2005.
- 10.15\* Form of Stock Grant Agreement for 2005 Stock Incentive Plan, incorporated herein by reference to Exhibit 99.2 to the Registrant's Current Report on Form 8-K dated October 14, 2005.
- 10.16\* Form of Notice of Stock Option Grant and Stock Option Agreement for 2005 Stock Incentive Plan, incorporated herein by reference to Exhibit 10.66 to the Registrant's Annual Report on Form 10-K for the fiscal year ended May 28, 2006.
- 10.17\* Form of Stock Unit Agreement for 2005 Stock Incentive Plan, incorporated herein by reference to Exhibit 10.67 to the Registrant's Annual Report on Form 10-K for the fiscal year ended May 28, 2006.
- 10.18\* Form of Stock Appreciation Right Agreement for 2005 Stock Incentive Plan, incorporated herein by reference to Exhibit 99.5 to the Registrant's Current Report on Form 8-K dated October 14, 2005.
- 10.19 Stock Purchase Agreement dated as of December 1, 2006 by and among the Registrant, Landec Ag and American Seeds, Inc., incorporated herein by reference to Exhibit 10.70 to the Registrant's Current Report on Form 8-K dated December 6, 2006.

Exhibit Number:	Exhibit Title						
10.20	License, Supply and R&D Agreement dated as of December 1, 2006 by and among the Registrant, Landec Ag and Monsanto Company, incorporated herein by reference to Exhibit 10.71 to the Registrant's Current Report on Form 8-K dated December 6, 2006.						
10.21*	2009 Cash Bonus Plan, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated July 22, 2008.						
10.22	Amendment No. 1 to the Amended and Restated Credit Agreement between Apio, Inc. and Wells Fargo Bank, N.A., dated as of September 1, 2007 incorporated herein by reference to Exhibit 10.73 to the Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended November 25, 2007.						
10.23*	Stock Option Agreement between the Registrant and Nicholas Tompkins dated as of November 29, 1999, incorporated herein by reference to Exhibit 10.25 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 31, 1999.						
10.24*	1999 Apio, Inc. Stock Option Plan and form of Option Agreement, incorporated herein by reference to Exhibit 10.26 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 31, 1999.						
10.25*	2000 Apio, Inc. Stock Option Plan and form of Option Agreement, incorporated herein by reference to Exhibit 10.28 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 29, 2000.						
16.1	Letter from McGladrey & Pullen, LLP, dated June 23, 2008 regarding change in independent registered public accounting firm, incorporated herein by reference to Exhibit 16.2 to the Registrant's Current Report on Form 8-K/A dated June 25, 2008.						
21.1	<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left; border-bottom: 1px solid black;">Subsidiary</th> <th style="text-align: left; border-bottom: 1px solid black;">State of Incorporation</th> </tr> </thead> <tbody> <tr> <td style="padding-left: 40px;">Landec Ag, Inc.</td> <td>Delaware</td> </tr> <tr> <td style="padding-left: 40px;">Apio, Inc.</td> <td>Delaware</td> </tr> </tbody> </table>	Subsidiary	State of Incorporation	Landec Ag, Inc.	Delaware	Apio, Inc.	Delaware
Subsidiary	State of Incorporation						
Landec Ag, Inc.	Delaware						
Apio, Inc.	Delaware						
23.1+	Consent of Independent Registered Public Accounting Firm.						
24.1+	Power of Attorney – See page 78						
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						
*	Represents a management contract or compensatory plan or arrangement required to be filed as an exhibit to this report pursuant to Item 15(b) of Form 10-K.						
+	Filed herewith.						
#	Confidential treatment requested as to certain portions. The term “confidential treatment” and the mark “*” as used throughout the indicated Exhibit means that material has been omitted and						

## SIGNATURES

Pursuant to the requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Menlo Park, State of California, on August 8, 2008.

### LANDEC CORPORATION

By: /s/ Gregory S. Skinner  
Gregory S. Skinner  
Vice President of Finance and Administration  
and Chief Financial Officer

### POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints Gary T. Steele and Gregory S. Skinner, and each of them, as his attorney-in-fact, with full power of substitution, for him in any and all capacities, to sign any and all amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming our signatures as they may be signed by our said attorney to any and all amendments to said Report on Form 10-K.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report on Form 10-K has been signed by the following persons in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Gary T. Steele</u> Gary T. Steele	President and Chief Executive Officer and Director (Principal Executive Officer)	August 8, 2008
<u>/s/ Gregory S. Skinner</u> Gregory S. Skinner	Vice President of Finance and Administration and Chief Financial Officer (Principal Financial and Accounting Officer)	August 8, 2008
<u>/s/ Nicholas Tompkins</u> Nicholas Tompkins	Chairman of the Board of Apio, Inc. and Director	August 8, 2008
<u>/s/ Robert Tobin</u> Robert Tobin	Director	August 8, 2008
<u>/s/ Duke K. Bristow, Ph.D</u> Duke K. Bristow, Ph.D	Director	August 8, 2008
<u>/s/ Frederick Frank</u> Frederick Frank	Director	August 8, 2008
<u>/s/ Stephen E. Halprin</u> Stephen E. Halprin	Director	August 8, 2008
<u>/s/ Richard S. Schneider, Ph.D</u> Richard S. Schneider, Ph.D	Director	August 8, 2008
<u>/s/ Kenneth E. Jones</u> Kenneth E. Jones	Director	August 8, 2008



## EXHIBIT INDEX

<b>Exhibit Number</b>	<b>Exhibit Title</b>
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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.

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in the Registration Statement (Form S-8 Nos. 333-109889, 333-89368, 333-62866, 333-06163, 333-29103, 333-80313, 333-52339, 333-129895) pertaining to the Non-Plan Stock Option, 1996 Stock Option Plan, New Executive Stock Option Plan, 1995 Employee Stock Purchase Plan, 1995 Directors' Stock Option Plan, 1996 Stock Option Plan, 1996 Non-Executive Stock Option Plan, 1988 Incentive Stock Option Plan, 2005 Stock Incentive Plan, of our reports dated August 7, 2008, with respect to the consolidated financial statements of Landec Corporation and the effectiveness of internal control over financial reporting of Landec Corporation, included in this Annual Report (Form 10-K) for the year ended May 25, 2008.

/s/ ERNST & YOUNG LLP

San Francisco, California  
August 7, 2008

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## CERTIFICATIONS

I, Gary T. Steele, certify that:

1. I have reviewed this annual report on Form 10-K of Landec Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2008

/s/ Gary T. Steele

Gary T. Steele  
President and Chief Executive Officer

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I, Gregory S. Skinner, certify that:

1. I have reviewed this annual report on Form 10-K of Landec Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2008

/s/ Gregory S. Skinner

Gregory S. Skinner

Vice President of Finance and Administration  
and Chief Financial Officer

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Landec Corporation (the "Company") on Form 10-K for the period ending May 25, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gary T. Steele, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: August 8, 2008

/s/ Gary T. Steele

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Gary T. Steele

*Chief Executive Officer and President*

*(Principal Executive Officer)*

\* The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not being filed as part of the Form 10-K or as a separate disclosure document.

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Landec Corporation (the "Company") on Form 10-K for the period ending May 25, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gregory S. Skinner, Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: August 8, 2008

/s/ Gregory S. Skinner

Gregory S. Skinner

*Vice President and Chief Financial Officer*

*(Principal Accounting Officer)*

\* The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not being filed as part of the Form 10-K or as a separate disclosure document.

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