

**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 28, 2006,**

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:**

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
None	None

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

**Common Stock**  
*(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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Act.

Large Accelerated Filer  Accelerated Filer  Non Accelerated Filer

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 \$130,470,000 as of November 27, 2005, the last business day of the registrant's most recently completed second fiscal quarter, based upon the closing sales price on The NASDAQ Global 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 7, 2006, there were 24,935,046 shares of Common Stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement relating to its October 2006 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 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. This proprietary polymer technology is the foundation, and a key differentiating advantage, upon which Landec has built its business.

The principal products and services offered by the Company in its two core businesses — Food Products Technology and Agricultural Seed Technology — and in the Technology Licensing/ Research and Development business are described below. Financial information concerning the industry segments for which the Company reported its operations during fiscal years 2004, 2005 and 2006 is summarized in Note 14 to the Consolidated Financial Statements.

Landec’s Food Products Technology business, operated through its subsidiary Apio, Inc., combines Landec’s proprietary food packaging technology with the capabilities of a large national food supplier and value-added produce processor. This combination was consummated in 1999 when the Company acquired Apio, Inc. and certain related entities (collectively “Apio”).

Landec’s Agricultural Seed Technology business, operated through its subsidiary Landec Ag, Inc. (“Landec Ag”), combines Landec’s proprietary Intellicoat® seed coating technology with its unique direct marketing and consultative selling capabilities which it obtained with its acquisition of Fielder’s Choice Direct (“Fielder’s Choice”), a direct marketer of hybrid seed corn, in 1997. In August 2005, Landec Ag acquired the assets of Heartland Hybrids, Inc. (“Heartland Hybrids”) and has combined the Heartland Hybrids® brand with its Fielder’s Choice® brand to sell seed corn, alfalfa and soybeans.

In addition to its two core businesses, the Company also operates a Technology Licensing/ Research and Development business that licenses products to, and conducts joint research and development with industry leaders outside of Landec’s core businesses, such as Air Products and Chemicals, Inc. (“Air Products”). The Company also engages in research and development activities and supplies products based on its Intelimer® polymer technology to companies such as Akzo Nobel and L’Oreal of Paris (these supply activities are included in the technology fields licensed to Air Products). For segment disclosure purposes, the Technology Licensing/ Research and Development business is included in Corporate and Other (in Note 14 to the Consolidated Financial Statements).

The Company’s core polymer products are based on its patented proprietary Intelimer® polymers, which differ from other polymers in that they can be customized to abruptly change their physical characteristics when heated or cooled through a pre-set temperature switch. For instance, Intelimer polymers can change within the range of one or two degrees Celsius from a non-adhesive state to a highly tacky, adhesive state; from an impermeable state to a highly permeable state; or from a solid state to a viscous 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.

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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 Market (formerly the Nasdaq National 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°C to 2°C. These changes can be designed to occur at relatively low temperatures (0°C to 100°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.

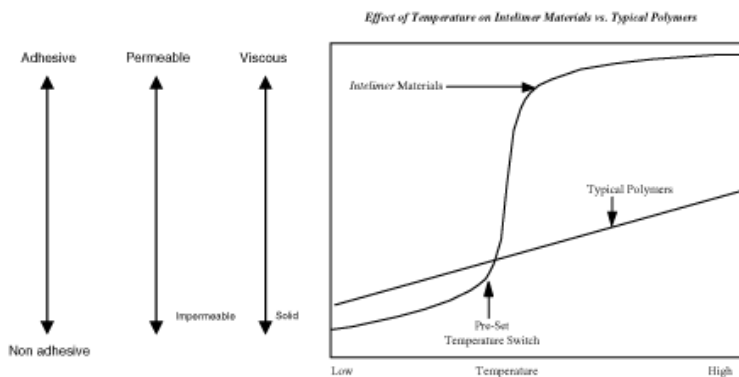
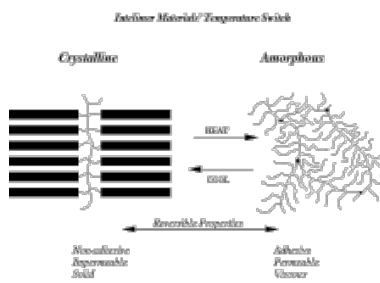


Figure 1.

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°C to 100°C by varying the length of the side chains. The reversible transitions between crystalline and amorphous states are illustrated in *Figure 2* below.

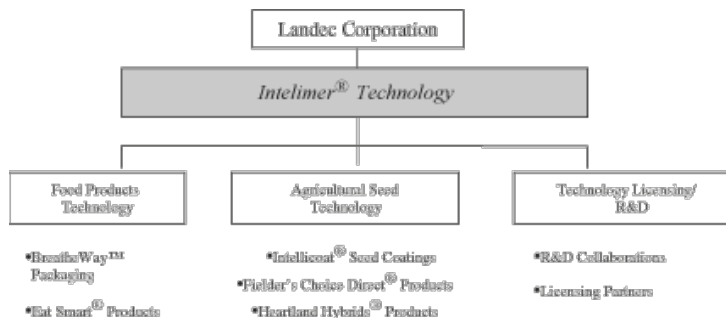


Side chain crystallizable polymers were first discovered by academic researchers in the mid-1950's. These polymers were initially considered to be merely of scientific curiosity from a polymer physics perspective, and, to the Company's knowledge, no significant commercial applications were pursued. In 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 drugs 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**

The Company participates in two core business segments — Food Products Technology and Agricultural Seed Technology. In addition to these two core segments Landec licenses technology and conducts ongoing research and development and supplies materials through its Technology Licensing/ Research and Development Business.



**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.

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

### *The Technology and Market Opportunity: Proprietary Intelimer 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 between \$100 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 packaged. 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 few current packaging films can fulfill. The Company believes that its temperature-responsive BreatheWay packaging technology is well suited to the challenges of the produce distribution process.

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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: Apio, Inc.*

Apio had revenues of approximately \$195 million for the fiscal year ended May 28, 2006, \$179 million for the fiscal year ended May 29, 2005 and \$168 million for the fiscal year ended May 30, 2004.

Based in Guadalupe, California, Apio, when acquired in 1999, consisted of two major businesses — first, the “fee-for-service” selling and marketing of whole produce and second, the specialty packaged fresh-cut and whole value-added processed products that are washed and packaged in our proprietary BreatheWay packaging. The “fee-for-service” business historically included field harvesting and packing, cooling and marketing of vegetables and fruit on a contract basis for growers in California’s Santa Maria, San Joaquin and Imperial Valleys as well as in Arizona and Mexico. The Company exited this business and certain assets associated with the business were sold in June 2003 to Beachside Produce, LLC (formerly known as Apio Fresh). Beachside Produce is owned by a group of entities and persons that supply produce to Apio, including Nicholas Tompkins, Apio’s President and Chief Executive Officer. Under the terms of the sale, Beachside Produce purchased certain equipment and carton inventory from Apio in exchange for approximately \$410,000. In connection with the sale, Beachside Produce will pay Apio an on-going royalty fee per carton sold

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for the use of Apio's brand names and Beachside Produce and its owner growers entered into a long-term supply agreement with Apio to supply produce to Apio for its fresh-cut value-added business. The fresh-cut value-added processed products business, developed within the last ten years, markets a variety of fresh-cut and whole vegetables to the top retail grocery chains and club stores. During the fiscal year ended May 28, 2006, Apio shipped nearly seventeen million cartons of produce to leading supermarket retailers, wholesalers, foodservice suppliers and club stores throughout the United States and internationally, primarily in Asia.

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

- *Value-Added Supplier:* Apio has structured its business as a marketer and seller of fresh-cut and whole value-added produce. It is focused on developing its Eat Smart® brand and other brands for all of its fresh-cut and whole value-added products. As retail grocery and club store chains consolidate, Apio is well positioned as a single source of a broad range of products.
- *Reduced Farming Risks:* Apio reduces its farming risk by not taking ownership of farmland, and instead, contracts with growers for produce. The year-round sourcing of produce is a key component to the fresh-cut and whole value-added processing business.
- *Lower Cost Structure:* Apio has strategically invested in the rapidly growing fresh-cut and whole value-added business. Apio's 60,000 square foot value-added processing plant is automated with state-of-the-art vegetable processing equipment. Virtually all of Apio's value-added products utilize Landec's proprietary BreatheWay packaging technology. Apio's strategy is to operate one large central processing facility in one of California's largest, lowest cost growing regions (Santa Maria Valley) and use packaging technology to allow for the nationwide delivery of fresh produce products.
- *Export Capability:* Apio is uniquely positioned to benefit from the growth in export sales to Asia and Europe over the next decade with its export business, CalEx. Through CalEx, Apio is currently one of the largest U.S. exporters of broccoli to Asia and is selling its iceless products to Asia using proprietary BreatheWay packaging technology.
- *Expanded Product Line Using Technology:* Apio, through the use of its BreatheWay packaging technology, is introducing on average fifteen new value-added products each year. These new product offerings range from various sizes of fresh-cut bagged products, to vegetable trays, to whole produce, to meal lines of products, to side dish lines of products. During fiscal year 2006 Apio introduced 19 new products.

Apio established in May 2005 its Apio Tech division to advance the sales of BreatheWay packaging technology for shelf-life sensitive vegetables and fruit, including unique packaging solutions for produce in large packages including shipping and pallet-sized containers.

For the past ten years, the Company has marketed its Eat Smart fresh-cut bagged vegetables, trays and iceless products using its BreatheWay packaging technology and has now expanded its technology to include packaging for bananas. In September 2004, Apio entered into an agreement with Chiquita whereby Apio will supply Chiquita with its proprietary banana packaging technology on a worldwide basis for the ripening, conservation and shelf-life extension of bananas in selective applications on an exclusive basis and for other applications on a non-exclusive basis. In addition, Apio will provide Chiquita with ongoing research and development, 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 annual minimum purchase thresholds of BreatheWay banana packages.



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The initial market focus for the BreatheWay banana packaging technology using Chiquita® Brand bananas will be commercial outlets that normally do not sell bananas because of their short shelf-life — outlets such as quick serve restaurants, convenience stores, drug stores and coffee chain outlets.

In addition to the introduction of specialty packaging for bananas, the Company is selling its BreatheWay packaging technology for case liner packaging for bunch and crown broccoli, eighteen pound cases of loose broccoli florets, Asian cut broccoli crowns and export cut broccoli crowns.

The Company's specialty packaging for case liner products reduces freight expense up to 50% 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 fiscal year 2006, sales of the value-added vegetable tray line grew 22%, and according to A.C. Nielsen, for the three months ended March 31, 2006, the Company's market share for sales of vegetable trays to retail grocery stores in the U.S. was 46%.

Foster Farms recently launched a new meal line that combines fresh cut vegetables and chicken which uses the Company's BreatheWay technology. In addition, the Company is in market tests for new lines of fresh cut vegetable side dishes and vegetable salads.

### ***Agricultural Seed Technology Business***

Landec Ag's strategy is to build a vertically integrated seed technology company based on its proprietary Intellicoat seed coating technology and its direct marketing and consultative selling capabilities.

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

Landec has developed and, through Landec Ag, is commercially selling its Intellicoat seed coatings, an Intelimer-based agricultural material designed to control seed germination timing, increase crop yields and extend crop planting windows. These coatings are being applied to corn and soybean seeds. According to the U.S. Agricultural Statistics Board, the total planted acreage in 2006 in the United States for corn and soybean seed was approximately 78 million and 77 million, respectively.

For the coating technology the strategy is to develop a patented, functional polymer coating technology that will be broadly licensed to the seed industry. The company will initially commercialize products for the corn and soybean markets and then broaden its applications to other seed crops. Landec Ag will use its Fielder's Choice Direct marketing and sales company to launch its applications for corn to build awareness for this technology and then broadly license its applications to the rest of the industry.

Landec Ag'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 2006 Pollinator Plus was used by 35 seed companies on approximately 15% of the seed production acres in the U.S.

In 2003, Landec Ag commercialized Early Plant® corn, its seed coating application for hybrid corn, by selling the product directly to farmers through its 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 2006, nine seed companies offered Intellicoat on their hybrid seed corn offerings.

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The third commercial application for seed coating is the Relay™ Cropping system of wheat and Intellicoat coated soybeans, which allows farmers to plant and harvest two crops in the same year on the same ground in geographic areas where double cropping is usually not possible. This provides significant financial benefit especially to farmers in the Corn Belt who grow wheat as a single crop.

### *The Business: Landec Ag*

Landec Ag had sales of approximately \$34.1 million for the fiscal year ended May 28, 2006, \$25.6 million for the fiscal year ended May 29, 2005 and \$23.6 million for the fiscal year ended May 30, 2004.

On August 29, 2005, Landec Ag closed the acquisition of Heartland Hybrids, Inc., the second largest direct marketer of seed corn after Landec Ag's Fielder's Choice Direct brand. With complementary strengths in geographic areas and sales channels, the new combined organization has the opportunity to develop the most efficient and effective sales, marketing and distribution system in the seed industry, expanding Landec Ag's sales of both uncoated seed and Intellicoat coated seed.

Based in Monticello, Indiana, Landec Ag offers a comprehensive line of corn hybrids and alfalfa to more than 12,500 farmers in over forty states through direct marketing programs. The success of Landec Ag comes, in part, from its expertise in selling directly to the farmer, bypassing the traditional and costly farmer-dealer system. We believe that this direct channel of distribution provides up to a 35% cost advantage compared to the farmer-dealer system.

In order to support its direct marketing programs, Landec Ag has developed a proprietary direct marketing, and consultative selling information technology that enables state-of-the-art methods for communicating with a broad array of farmers. This proprietary direct marketing information technology includes a current database of over 163,000 farmers.

The acquisitions by Landec Ag of Fielder's Choice in 1997 and Heartland Hybrids in 2005 were strategic in providing a cost-effective vehicle for marketing Intellicoat seed coating products. The Company believes that the combination of coating technology and a direct channel of distribution, telephonic and electronic commerce capabilities will enable Landec Ag to more quickly achieve meaningful market penetration.

### **Technology Licensing/ Research and Development Businesses**

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

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products. The rights to develop and sell Landec's latent catalysts and personal care technologies were licensed to Air Products in March 2006. Landec's pressure sensitive adhesives ("PSA") technology is currently being evaluated in a variety of industrial and medical applications where strong adhesion to a substrate (i.e. steel, glass, silicon, skin, etc.) is desired for a defined time period and upon thermal triggering, results in a significant peel strength reduction. For example, select PSA systems exhibit greater than 90% reduction in peel strength upon warming, making them ideal for applications on fragile substrates.

### *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 of Paris for use in lotions and creams. 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 a medical device company. This company paid Landec an upfront license fee of \$250,000 for the exclusive rights to use Landec's Intelimer materials technology in a specific device field 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 \$1.3 million which represents a 19.9% ownership interest in the medical device company. At this time, the Company is unable to predict the ultimate outcome of the collaboration with the medical device company 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 year 2006, sales to the Company's top five customers accounted for approximately 46% of its revenues, with the top customer, Costco Wholesale Corp., accounting for approximately 16% of the Company's revenues.

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

Apio has 18 sales people, located in central California and throughout the U.S., supporting the export business and the specialty packaged value-added produce business.

### ***Agricultural Seed Technology Business***

Landec Ag utilizes 49 seed sales consultants and associates located in Monticello, Indiana and Dassel, Minnesota for its direct marketing of seed corn and Intellicoat coated products. Customer contacts are made based on direct responses and inquiries from customers.

### ***Seasonality***

The Company's sales are moderately seasonal. Historically, our direct marketer of hybrid corn seed, Landec Ag, has seen its revenues and profits concentrated over a few months during the spring planting season (generally during the Company's third and fourth quarters). In addition, Apio can be heavily affected by seasonal weather factors which have impacted quarterly results, such as high cost of sourcing product in December 2003, January 2004 and March/ April 2005 due to a shortage of essential value-added produce items.

## **Manufacturing and Processing**

Landec intends to control the manufacturing of its own products whenever possible, as it believes that there is considerable manufacturing margin opportunity in its products. In addition, the Company believes that know-how and trade secrets can be better maintained by Landec retaining some manufacturing capabilities in-house.

### ***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 company in which Apio has a 60% ownership interest and is the general partner.

### ***Agricultural Seed Technology 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 the commercialization of its Early Plant corn and for its Relay Cropping System for wheat/coated soybean products. This facility utilizes a continuous coating process that has increased seed coating capabilities by tenfold compared to the previous system using batch coaters. Landec Ag contracts for production of its hybrid seed corn from established seed producers.

### ***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. In addition, a large majority of the hybrid corn varieties sold by Landec Ag are sourced from a single seed producer. Upon manufacturing scale-up of seed coating operations and as hybrid corn sales increase, 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 nor has Landec Ag experienced difficulty in acquiring hybrid corn varieties, 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 or hybrid corn varieties 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 28, 2006, May 29, 2005 and May 30, 2004 were \$3.0 million, \$2.5 million and \$3.5 million, respectively. Research and development expenditures funded by corporate partners were \$100,000 for fiscal year ended May 28, 2006, \$20,000 for the fiscal year ended May 29, 2005 and \$173,000 for the fiscal year ended May 30, 2004. 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 28, 2006, Landec had 23 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 twenty-five active U.S. patents with expiration dates ranging from 2009 to 2021 and has filed applications for additional U.S. patents, as well as certain corresponding patent applications outside the United States, relating to the Company's technology. 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

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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 28, 2006, Landec had 186 full-time employees, of whom 50 were dedicated to research, development, manufacturing, quality control and regulatory affairs and 136 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 relationships with its employees are 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, our direct marketer of hybrid corn seed, Landec Ag, has been the primary source of these fluctuations, as its revenues and profits are 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 December 2003, January 2004 and March/ April 2005 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;

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- 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 or hybrid corn varieties 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. In addition, a majority of the hybrid corn varieties sold by Landec Ag are grown under contract by a single seed producer. Any interruption of our relationship with single-source suppliers or service providers could delay product shipments and materially harm our business.

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

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

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

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

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



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

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

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

Our Food Products and Agricultural Seed Technology businesses are 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

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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 28, 2006, approximately 22% 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 2006, sales to our top five customers accounted for approximately 46% of our revenues, with our largest customers, Costco Wholesale Corp. and Sam's Club, accounting for approximately 16% and 14%, respectively, of our revenues. We expect that, for the foreseeable future, a limited number of customers may continue to account for a substantial portion of our 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.

***Since We Order Cartons and Film for Our Products from Suppliers in Advance of Receipt of Customer Orders for Such Products, We Could Face a Material Inventory Risk***

As part of our inventory planning, we enter into negotiated orders with vendors of cartons and film used for packing our products in advance of receiving customer orders for such products. Accordingly, we face the risk of ordering too many cartons and film since orders are generally based on forecasts of customer orders rather than actual orders. If we cannot change or be released from the orders, we may incur costs as a result of inadequately predicting cartons and film orders in advance of customer orders. Because of this, we may have an oversupply of cartons and film and face the risk of not being able to sell such inventory and our anticipated reserves for losses may be inadequate if we have misjudged the demand for our products. Our business and operating results could be adversely affected as a result of these increased costs.

***Our Seed Products May Fail to Germinate Properly and We May Be Subject to Claims for Reimbursement or Damages for Losses from Customers Who Use Such Products***

Farmers plant seed products sold by Landec Ag with the expectation that they will germinate under normal growing conditions. If our seed products do not germinate at the appropriate time or fail to germinate at all, our customers may incur significant crop losses and seek reimbursement or bring claims against us for such damages. Although insurance is generally available to cover such claims, the costs for premiums of such policies are prohibitively expensive and we currently do not maintain such insurance. Any claims brought for failure of our seed products to properly germinate could materially and adversely affect our operating and financial results.

***Recently Enacted Changes in Securities Laws and Regulations Have and Will Continue to Increase Our Costs***

The Sarbanes-Oxley Act of 2002 (the "Act") that became law in July 2002 required changes in some of our corporate governance, public disclosure and compliance practices. In addition, Nasdaq has made revisions to its requirements for companies, such as Landec, that are listed on The NASDAQ Global Market. These developments have increased our legal and financial compliance costs. These changes could make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These developments could make it more difficult for us to attract and retain qualified members for our board of directors, particularly to serve on our audit committee.

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

Our executive officers and directors and their affiliates own or control approximately 23% 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 on November 19, 2002 and the Series B Convertible Preferred Stock was converted into 1,744,102 shares of Common Stock on May 7, 2004.

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

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

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

***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.

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The Company owns or leases properties in Menlo Park, Arroyo Grande and Guadalupe, California; West Lebanon, Oxford and Monticello, Indiana; Danville, Illinois; Dassel, Minnesota and Kinsman, Ohio.

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	Other	Leased	10,400 square feet of office and laboratory space	—	12/31/06
Monticello, IN	Agricultural Seed Technology	Owned	19,400 square feet of office space	0.5	—
West Lebanon, IN	Agricultural Seed Technology	Owned	4,000 square feet of warehouse and manufacturing space	—	—
Oxford, IN	Agricultural Seed Technology	Leased	13,400 square feet of laboratory and manufacturing space	—	6/30/06
Danville, IL	Agricultural Seed Technology	Leased	200,000 square feet of warehouse space	—	12/31/08
Dassel, MN	Agricultural Seed Technology	Leased	4,600 square feet of office space	—	5/31/08
Dassel, MN	Agricultural Seed Technology	Leased	35,200 square feet of warehouse space	—	5/31/08
Dassel, MN	Agricultural Seed Technology	Leased	7,200 square feet of vehicle maintenance shop space	—	5/31/08
Kinsman, OH	Agricultural Seed Technology	Leased	6,600 square feet of warehouse space	—	08/1/07
Guadalupe, CA	Food Products Technology	Owned	106,000 square feet of office space, manufacturing and cold storage	17.7	—
Arroyo Grande, CA	Food Products Technology	Leased	1,100 square feet of office space	—	6/30/08

There are bank liens encumbering all 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 would 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 28, 2006.

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

<b>Fiscal Year Ended May 28, 2006</b>	<b>High</b>	<b>Low</b>
4th Quarter ending May 28, 2006	\$ 9.65	\$ 6.71
3rd Quarter ending February 26, 2006	\$ 7.84	\$ 6.23
2nd Quarter ending November 27, 2005	\$ 8.01	\$ 6.32
1st Quarter ending August 28, 2005	\$ 6.98	\$ 6.66

<b>Fiscal Year Ended May 29, 2005</b>	<b>High</b>	<b>Low</b>
4th Quarter ending May 29, 2005	\$ 8.25	\$ 5.77
3rd Quarter ending February 27, 2005	\$ 7.72	\$ 6.00
2nd Quarter ending November 28, 2004	\$ 8.00	\$ 4.50
1st Quarter ending August 29, 2004	\$ 7.40	\$ 4.28

**Holders**

There were approximately 84 holders of record of 24,935,046 shares of outstanding Common Stock as of July 7, 2006. 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.

**Unregistered Sales of Equity Securities**

Pursuant to the Asset Purchase Agreement dated June 29, 2005, the Company on August 29, 2005 issued 152,186 shares of Common Stock valued at \$960,000 to the former owners of Heartland Hybrids, Inc.

The issuance of these securities was deemed to be exempt from registration under the Securities Act of 1933, as amended (the "Act"), in reliance on Section 4(2) of the Act as a transaction by an issuer not involving any public offering. The recipients of the securities in such transaction represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof and also represented that each is an "accredited investor" with the meaning of Rule 501(a) of Regulation D under the Act. Appropriate legends were affixed to the securities issued in such transaction. The recipients were given adequate access to information about the Company.

**Issuer Purchases of Equity Securities**

There were no shares repurchased by the Company during the quarter ending on May 28, 2006.

**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 28, 2006	Year Ended May 29, 2005	Year Ended May 30, 2004	Seven Months Ended May 25, 2003	Seven Months Ended June 2, 2002  (Unaudited)	Year Ended October 27, 2002	Year Ended October 28, 2001
(In thousands)							
<b>Statements of Operations Data:</b>							
Revenues:							
Product sales	\$225,404	\$201,020	\$185,664	\$ 98,689	\$ 96,513	\$152,958	\$ 141,314
Services revenue	3,725	3,704	5,791	12,784	15,882	26,827	48,429
License fees	2,398	88	88	357	1,274	2,330	374
Research, development and royalty revenues	426	418	549	429	402	1,040	529
<b>Total revenues</b>	<b>231,953</b>	<b>205,230</b>	<b>192,092</b>	<b>112,259</b>	<b>114,071</b>	<b>183,155</b>	<b>190,646</b>
Cost of revenue:							
Cost of product sales	188,904	170,359	158,911	82,339	80,680	131,352	122,081
Cost of services revenue	3,005	2,899	3,390	9,216	12,505	20,463	40,751
<b>Total cost of revenue</b>	<b>191,909</b>	<b>173,258</b>	<b>162,301</b>	<b>91,555</b>	<b>93,185</b>	<b>151,815</b>	<b>162,832</b>
<b>Gross profit</b>	<b>40,044</b>	<b>31,972</b>	<b>29,791</b>	<b>20,704</b>	<b>20,886</b>	<b>31,340</b>	<b>27,814</b>
Operating costs and expenses:							
Research and development	3,042	2,543	3,452	2,118	2,018	3,532	3,270
Selling, general and administrative	27,979	23,412	22,284	15,185	16,293	26,114	27,398
Exit of domestic commodity vegetable business	—	—	—	1,095	—	—	—
<b>Total operating costs and expenses</b>	<b>31,021</b>	<b>25,955</b>	<b>25,736</b>	<b>18,398</b>	<b>18,311</b>	<b>29,646</b>	<b>30,668</b>
<b>Operating profit (loss)</b>	<b>9,023</b>	<b>6,017</b>	<b>4,055</b>	<b>2,306</b>	<b>2,575</b>	<b>1,694</b>	<b>(2,854)</b>
Interest income	633	214	164	144	177	247	617
Interest expense	(452)	(414)	(811)	(642)	(1,097)	(1,551)	(2,789)
Minority interest expense	(529)	(411)	(537)	(235)	(224)	(525)	(28)
Other (expense)/income, net	(24)	(4)	29	218	71	336	216
<b>Income (loss) from continuing operations</b>	<b>8,651</b>	<b>5,402</b>	<b>2,900</b>	<b>1,791</b>	<b>1,502</b>	<b>201</b>	<b>(4,838)</b>
Discontinued Operations:							
Loss from discontinued operations	—	—	—	—	—	—	(537)
Loss on disposal of operations	—	—	—	—	—	(1,688)	(2,500)
<b>Loss from discontinued operations</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(1,688)</b>	<b>(3,037)</b>
<b>Net income (loss)</b>	<b>\$ 8,651</b>	<b>\$ 5,402</b>	<b>\$ 2,900</b>	<b>\$ 1,791</b>	<b>\$ 1,502</b>	<b>\$ (1,487)</b>	<b>\$ (7,875)</b>
<b>Net income (loss)</b>	<b>\$ 8,651</b>	<b>\$ 5,402</b>	<b>\$ 2,900</b>	<b>\$ 1,791</b>	<b>\$ 1,502</b>	<b>\$ (1,487)</b>	<b>\$ (7,875)</b>
Dividends on Series B preferred stock	—	—	(464)	(219)	(202)	(412)	—
<b>Net income (loss) applicable to common shareholders</b>	<b>\$ 8,651</b>	<b>\$ 5,402</b>	<b>\$ 2,436</b>	<b>\$ 1,572</b>	<b>\$ 1,300</b>	<b>\$ (1,899)</b>	<b>\$ (7,875)</b>



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The gain of \$436,000 in fiscal year 2002 on the sale of the fruit processing facility has been reclassified as it appears in prior filings from other income to selling, general and administrative expenses.

	Year Ended May 28, 2006	Year Ended May 29, 2005	Year Ended May 30, 2004	Seven Months Ended May 25, 2003	Seven Months Ended June 2, 2002	Year Ended October 27, 2002	Year Ended October 28, 2001
(Unaudited)							
(In thousands, except per share data)							
<b>Statements of Operations Data:</b>							
Basic net income (loss) per share:							
Continuing operations	\$ 0.35	\$ 0.23	\$ 0.11	\$ 0.08	\$ 0.07	\$ (0.01)	\$ (0.29)
Discontinued operations	—	—	—	—	—	(0.09)	(0.19)
<b>Basic net income (loss) per share</b>	<b>\$ 0.35</b>	<b>\$ 0.23</b>	<b>\$ 0.11</b>	<b>\$ 0.08</b>	<b>\$ 0.07</b>	<b>\$ (0.10)</b>	<b>\$ (0.48)</b>
Diluted net income (loss) per share:							
Continuing operations	\$ 0.32	\$ 0.21	\$ 0.12	\$ 0.07	\$ 0.06	\$ (0.01)	\$ (0.29)
Discontinued operations	—	—	—	—	—	(0.09)	(0.19)
<b>Diluted net income (loss) per share</b>	<b>\$ 0.32</b>	<b>\$ 0.21</b>	<b>\$ 0.12</b>	<b>\$ 0.07</b>	<b>\$ 0.06</b>	<b>\$ (0.10)</b>	<b>\$ (0.48)</b>
Shares used in per share computation:							
Basic	24,553	23,705	21,396	20,948	17,777	18,172	16,371
Diluted	25,657	24,614	23,556	22,626	21,082	18,172	16,371

	May 28, 2006	May 29, 2005	May 30, 2004	May 25, 2003	October 27, 2002	October 28, 2001
(In thousands)						
<b>Balance Sheet Data:</b>						
Cash and cash equivalents	\$ 20,519	\$ 12,871	\$ 6,458	\$ 3,699	\$ 7,849	\$ 8,695
Total assets	119,025	100,075	93,007	96,887	107,803	120,122
Debt	2,018	3,088	8,996	13,494	17,543	33,416
Convertible preferred stock	—	—	—	5,531	14,461	14,049
Accumulated deficit	(41,239)	(49,890)	(55,292)	(57,728)	(59,300)	(57,401)
Total shareholders' equity	\$ 85,049	\$ 72,060	\$ 61,549	\$ 57,903	\$ 55,963	\$ 49,839

**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; Intelimer packaging technology for the fresh-cut and whole produce

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packaging market, in September 1995; Intelimer Polymer Systems in June 1997 that includes polymer materials for various industrial applications and beginning in November 2003 for personal care applications; and Intellicoat coated corn seeds in the Fall of 1999.

With the acquisition of Apio in December 1999 and Landec Ag in September 1997, the Company is focused on two core businesses — Food Products Technology and Agricultural Seed Technology. The Food Products Technology segment combines the Company's Intelimer packaging technology with Apio's fresh-cut and whole produce business. The Agricultural Seed Technology segment integrates the Intellicoat seed coating technology with Landec Ag's direct marketing, telephone sales and distribution capabilities. The Company also operates a Technology Licensing/Research and Development business which develops products to be licensed outside of the Company's core businesses. See "Business — Description of Core Business".

From inception through May 28, 2006, the Company's accumulated deficit was \$41.2 million. The Company may incur additional losses in the future. The amount of future net profits, if any, is highly 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 the Company's financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances.

#### ***Notes and Advances Receivables***

Apio has made advances to fruit growers for the development of orchards, and to produce growers for crop and harvesting costs. Typically, except for development advances, these advances are paid off within the growing season (less than one year) from harvested crops. Development advances and 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 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.

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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.

### **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 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.

Prior to November 1, 1999, the Company recognized noncancellable, nonrefundable license fees as revenue when received and when all significant contractual obligations of the Company relating to the fees had been met. Effective November 1, 1999, the Company changed its method of accounting for noncancellable, nonrefundable license fees to recognize such fees 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. The Company believes the change in accounting principle is preferable based on guidance provided in SAB 104. In the fiscal year ended October 29, 2000, the Company recorded a charge of \$1.9 million related to the cumulative effect of the change in accounting principle. The cumulative effect was initially recorded as deferred revenue and has been recognized as recycled revenue over the research and development period or supply period commitment of the agreement. "Recycled" revenue refers to revenue that had previously been recognized as licensing revenue in the Company's financial statements, but as a result of the Company's adoption of SAB 104, was reversed through a cumulative effect of a change in accounting in fiscal year 2000 and has been recognized as revenue over the research and development period and/or the supply period commitment of the agreement, whichever is longer.

In July 2005, the Company amended its supply agreement with Alcon, Inc. ("Alcon") to change the expiration date of the agreement from November 1, 2012 to May 28, 2006. In accordance with SAB 104, the entire amount of the deferred revenue of \$638,000 as of May 29, 2005, was recognized as "recycled" revenue during fiscal year 2006.

During the fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004, \$638,000, \$88,000 and \$88,000, respectively, of the related deferred revenue was recognized as "recycled" revenue. As of May 28, 2006, deferred revenue associated with the change in accounting principles described above is zero.

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. 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 would likely be 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. SFAS No. 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax assets will not be realized. The Company evaluates quarterly the realizability of its deferred tax assets by assessing the valuation allowance and, if necessary, adjusts the amount of such allowance. The factors used to assess the likelihood of realization include the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. Due to the Company's limited tax basis earnings history, the net deferred tax asset at May 28, 2006 has been fully offset by a valuation allowance.

### **Recent Accounting Pronouncements**

#### ***Accounting for Stock-Based Compensation***

In December 2004, the FASB issued Statement No. 123 (revised 2004), *Share-Based Payment*, or SFAS No. 123R, which is a revision of SFAS No. 123, and supersedes APB Opinion 25. SFAS 123R requires all share-based payments to employees and directors, including grants of stock options, to be recognized in the statement of operations based on their fair values. On April 14, 2005, the SEC adopted a new rule that amended the compliance dates for SFAS 123R such that the Company is now allowed to adopt the new standard effective in the first quarter of fiscal year 2007. The pro forma disclosures previously permitted under SFAS 123 will no longer be an alternative to financial statement recognition. As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB Opinion 25's intrinsic value method and, as such, recognizes no compensation cost for employee stock options.

Under SFAS 123R, the Company must determine the appropriate fair value model and related assumptions to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition methods include modified prospective and retroactive adoption options. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The modified prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive method would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. The Company has decided to adopt the modified prospective method. The Company is currently evaluating the requirements of SFAS 123R as well as option valuation methodologies related to its stock option plans. The Company's preliminary estimate indicates that the effect of adopting SFAS 123R could result in a pre tax charge to net income of up to approximately \$500,000 in fiscal year 2007. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption.

**Results of Operations*****Fiscal Year Ended May 28, 2006 Compared to Fiscal Year Ended May 29, 2005*****Revenues:**

	<u>Fiscal Year Ended May 28, 2006</u>	<u>Fiscal Year Ended May 29, 2005</u>	<u>Change</u>
		(In thousands)	
Apio Value Added	\$ 136,141	\$ 120,445	13%
Apio Trading	57,990	58,660	(1)%
Apio Tech	685	52	1217%
Total Apio	194,816	179,157	9%
Landec Ag	34,096	25,648	33%
Corporate	3,041	425	616%
<b>Total Revenues</b>	<b>\$ 231,953</b>	<b>\$ 205,230</b>	<b>13%</b>

***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 which is now combined with value-added.

The increase in Apio's value-added revenues for the fiscal year ended May 28, 2006 compared to the same period last year is due to increased product offerings, increased sales to existing customers, the addition of new customers and product mix changes to higher priced products. Specifically, sales of Apio's value-added 12-ounce specialty packaged retail product line grew 16% and sales of Apio's value-added vegetable tray products grew 22% during the fiscal year ended May 28, 2006 compared to the same period last year. Overall value-added sales volume increased 10% during the fiscal year ended May 28, 2006 compared to the same period last year.

***Apio Trading***

Apio trading revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia through Apio's export company, Cal-Ex and from the purchase and sale of whole commodity fruit and vegetable products domestically to Wal-Mart. The export portion of trading revenues for fiscal year 2006 was \$50.3 million or 87% of total trading revenues.

The decrease in revenues in Apio's trading business for the fiscal year ended May 28, 2006 compared to the same period last year was primarily due to a 23% decrease in the domestic buy/sell commodity sales to Wal-Mart. Overall trading sales volumes were lower by 2% for the fiscal year ended May 28, 2006 compared to the same period last year. The decrease in volumes was partially offset by higher average sales prices due to the scarcity of product during certain months of the year.

***Apio Tech***

Apio Tech consists of Apio's packaging technology business using its BreatheWay™ membrane technology. The first commercial application included in Apio Tech is the banana packaging technology. Current revenues generated from Apio Tech are primarily from the banana program with Chiquita.

The increase in Apio Tech revenues for the fiscal year ended May 28, 2006 compared to the same period last year was not material to consolidated Landec revenues.

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**Landec Ag**

Landec Ag revenues consist of revenues generated from the sale of hybrid seed corn to farmers under the Fielder's Choice Direct® and Heartland Hybrids® brands and from the sale of Intellicoat coated corn and soybean seeds to farmers and seed companies. For the fiscal years ended May 28, 2006 and May 29, 2005, over 95% of Landec Ag's revenues were from the sale of uncoated hybrid seed corn.

The increase in revenues at Landec Ag during the fiscal year ended May 28, 2006 compared to the same period last year was primarily due to sales under the Heartland Hybrids brand which was acquired on August 29, 2005.

**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 increase in Corporate revenues for the fiscal year ended May 28, 2006 compared to the same period of the prior year was primarily due to (1) \$1.56 million in revenues received from the license of our Intelimer technology in a specific field to a medical device company in December 2005, (2) \$300,000 in licensing fees and research and development revenues from the license of our Intelimer technology in specific fields to Air Products in March 2006 and (3) the recognition of the remaining \$550,000 of deferred revenue associated with the Alcon license agreement through the revised agreement termination date of May 28, 2006.

**Gross Profit:**

	Fiscal Year Ended May 28, 2006	Fiscal Year Ended May 29, 2005	Change
		(In thousands)	
Apio Value Added	\$ 23,022	\$ 19,062	21%
Apio Trading	3,212	3,118	3%
Apio Tech	619	15	4027%
Total Apio	26,853	22,195	21%
Landec Ag	10,439	9,448	10%
Corporate	2,752	329	736%
Total Gross Profit	<u>\$ 40,044</u>	<u>\$ 31,972</u>	25%

**General**

There are numerous factors that can influence gross profits including product mix, customer mix, manufacturing costs, volume, sale discounts and charges for excess or obsolete inventory, to name a few. Many of these factors influence or are interrelated with other factors. Therefore, it is difficult to precisely quantify the impact of each item individually. The Company includes in cost of sales all the costs related to the sale of products in accordance with 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 profits includes management's best estimates of the reasons for the changes for the fiscal year ended May 28, 2006 compared to the same period last year as outlined in the table above.

**Apio Value-Added**

The increase in gross profits for Apio's value-added specialty packaged vegetable business for the fiscal year ended May 28, 2006 compared to the same period last year was due to (1) the increase in value-added sales which increased 13% during fiscal year 2006, (2) product mix changes to higher margin products and

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(3) improved operational efficiencies driven largely by improved raw material quality during fiscal year 2006 compared to the prior fiscal year.

**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 profits during the fiscal year ended May 28, 2006 compared to the prior fiscal year was primarily due to product mix changes to higher margin products which more than offset the reduction in revenues.

**Apio Tech**

The increase in gross profits for Apio Tech for the fiscal year ended May 28, 2006 compared to the same period last year was primarily due to the revenues received from our banana packaging agreement with Chiquita.

**Landec Ag**

The increase in gross profits for Landec Ag for the fiscal year ended May 28, 2006 compared to the same period last year was due to the increase in revenues as a result of the acquisition of Heartland Hybrids in August 2005, partially offset by higher royalty fees on corn seed hybrids with traits, such as genetics and certain chemicals, resulting in lower gross profits as a percentage of sales in fiscal year 2006 compared to the same period last year.

**Corporate**

The increase in gross profits for Corporate for the fiscal year ended May 28, 2006 compared to the same period last year was primarily due to (1) \$1.56 million in revenues received from the license of our Intelimer technology in a specific field to a medical device company in December 2005, (2) \$300,000 in licensing fees and research and development revenues from the license of our Intelimer technology in specific fields to Air Products in March 2006 and (3) the recognition of the remaining \$550,000 of deferred revenue associated with the Alcon license agreement through the revised agreement termination date of May 28, 2006.

**Operating Expenses:**

	Fiscal Year Ended May 28, 2006	Fiscal Year Ended May 29, 2005	Change
	(In thousands)		
<b>Research and Development:</b>			
<b>Apio</b>	\$ 1,108	\$ 831	33%
<b>Landec Ag</b>	470	647	(27)%
<b>Corporate</b>	1,464	1,065	37%
<b>Total R&amp;D</b>	<u>\$ 3,042</u>	<u>\$ 2,543</u>	20%
<b>Selling, General and Administrative:</b>			
<b>Apio</b>	\$ 13,633	\$ 12,354	10%
<b>Landec Ag</b>	9,616	7,857	22%
<b>Corporate</b>	4,730	3,201	48%
<b>Total S,G&amp;A</b>	<u>\$ 27,979</u>	<u>\$ 23,412</u>	20%

**Research and Development**

Landec's research and development expenses consist primarily of expenses involved in the development and process scale-up initiatives. Research and development efforts at Apio are focused on the Company's

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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. At Corporate, the research and development efforts are 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 28, 2006 compared to the same period last year was due to increased efforts expended at Apio Tech to expand its initiatives to programs beyond just bananas and increased expenses at Corporate to support new collaborations, including the addition of Landec's COO, Dr. David Taft, who was the COO of Apio in fiscal year 2005.

**Selling, General and Administrative**

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

The increase in selling, general and administrative expenses for the fiscal year ended May 28, 2006 compared to the same period last year was primarily due to (1) selling, general and administrative expenses of \$2.0 million at Heartland Hybrids, (2) planned increases in selling and marketing expenses at Apio and Landec Ag to generate increases in revenues, (3) an increase in general and administrative expenses at Corporate for business development consulting fees and legal fees, (4) the accrual of bonuses for exceeding our fiscal year 2006 internal plan and (5) in fiscal year 2005 a \$713,000 gain on the sale of land at Apio was netted against selling, general and administrative expenses.

**Other:**

	<u>Fiscal Year Ended May 28, 2006</u>	<u>Fiscal Year Ended May 29, 2005</u>	<u>Change</u>
		(In thousands)	
<b>Interest Income</b>	\$ 633	\$ 214	196%
<b>Interest Expense</b>	(452)	(414)	9%
<b>Minority Interest Expense</b>	(529)	(411)	29%
<b>Other Expenses</b>	(24)	(4)	500%
<b>Total Other Expense</b>	<u>\$ (372)</u>	<u>\$ (615)</u>	(40)%

**Interest Income**

The increase in interest income for the fiscal year ended May 28, 2006 compared to the same period last year was primarily due to the increase in cash available for investing and higher average interest rates on those investments.

**Interest Expense**

The increase in interest expense during the fiscal year ended May 28, 2006 compared to the same period last year was due to higher average interest rates on the Company's debt.

**Minority Interest Expense**

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

The increase in the minority interest expense in fiscal year 2006 compared to fiscal year 2005 was due to higher net income for Apio Cooling in fiscal year 2006 compared to fiscal year 2005.



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**Other Expenses**

Other consists of non-operating income and expenses.

**Fiscal Year Ended May 29, 2005 Compared to Fiscal Year Ended May 30, 2004**

**Revenues:**

	Fiscal Year Ended May 29, 2005	Fiscal Year Ended May 30, 2004	Change
		(In thousands)	
Apio Value Added	\$ 116,741	\$ 101,067	16%
Apio Trading	58,660	59,311	(1)%
Apio Tech	52	1,715	(97)%
Apio Service	3,704	5,793	(36)%
Total Apio	179,157	167,886	7%
Landec Ag	25,648	23,641	8%
Corporate	425	565	(25)%
Total Revenues	<u>\$ 205,230</u>	<u>\$ 192,092</u>	7%

**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, the Dole brand and various private labels.

The increase in Apio's value-added revenues for the fiscal year ended May 29, 2005 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 13% and sales of Apio's value-added vegetable tray products grew 60% during the fiscal year ended May 29, 2005 compared to the same period last year. Overall value-added sales volume increased 9% during the fiscal year ended May 29, 2005 compared to the same period last year.

**Apio Trading**

Apio trading revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia through Apio's export company, Cal-Ex and from the purchase and sale of whole commodity fruit and vegetable products domestically to Wal-Mart. The export portion of trading revenues for fiscal year 2005 was \$48.8 million or 83% of total trading revenues.

The slight decrease in revenues in Apio's trading business for the fiscal year ended May 29, 2005 compared to the same period last year was primarily due to produce shortages during the winter months as a result of near record rains in the Western portion of the United States. Trading sales volumes were lower by 7% for the fiscal year ended May 29, 2005 compared to the same period last year. The decrease in volumes was virtually offset by higher average sales prices due to the scarcity of product during certain months of the year.

**Apio Tech**

Apio Tech consists of Apio's packaging technology business using its BreatheWay™ membrane technology. The first commercial application included in Apio Tech is our banana packaging technology. Current revenues generated from Apio Tech are from the sale of our proprietary packaging for bananas.

The decrease in revenues from the sale of bananas for the fiscal year ended May 29, 2005 compared to the same period last year was due to the Company only selling banana packaging not bananas themselves in

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fiscal year 2005. In addition, the sales of banana packaging occurred solely during the Company's fourth fiscal quarter of fiscal year 2005 and were for market trial purposes.

**Apio Service**

Prior to its sale on June 30, 2003 to Beachside Produce, Apio operated a domestic commodity vegetable business that marketed and sold whole produce for growers. Apio charged a per carton service fee for marketing and selling these whole commodity products. Subsequent to June 30, 2003, Apio's service revenues consist of revenues generated from Apio Cooling, LP.

The decrease in service revenues during the fiscal year ended May 29, 2005 compared to the same period last year is due to a 2% decrease in volumes in Apio's cooling operation due to lower commodity product volumes from Beachside Produce and one month of commodity revenues in fiscal year 2004 before the sale to Beachside Produce.

**Landec Ag**

Landec Ag revenues consist of revenues generated from the sale of hybrid seed corn to farmers under the Fielder's Choice Direct® brand and from the sale of Intellicoat coated corn and soybean seeds to farmers and seed companies. For the fiscal years ended May 29, 2005 and May 30, 2004, over 90% of Landec Ag's revenues were from the sale of uncoated hybrid seed corn under the Fielder's Choice brand.

The increase in revenues at Landec Ag during the fiscal year ended May 29, 2005 compared to the same period last year is due to a change in product mix to higher priced hybrid corn varieties that resulted in a 4% increase in the average price per unit. In addition, sales volumes increased 5% in fiscal year 2005 compared to fiscal year 2004.

**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 28, 2005 compared to the same period of the prior year is primarily due to the completion of two R&D contracts (UCB and a medical device collaboration) in early fiscal year 2004 which resulted in R&D revenues decreasing \$152,000 in fiscal year 2005 compared to fiscal year 2004.

**Gross Profit:**

	Fiscal Year Ended May 29, 2005	Fiscal Year Ended May 30, 2004	Change
		(In thousands)	
Apio Value Added	\$ 18,257	\$ 15,794	16%
Apio Trading	3,118	2,898	8%
Apio Tech	15	(862)	102%
Apio Service	805	2,401	(66)%
Total Apio	22,195	20,231	10%
Landec Ag	9,448	9,086	4%
Corporate	329	474	(31)%
Total Gross Profit	\$ 31,972	\$ 29,791	7%

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### **General**

There are numerous factors that can influence gross profits including product mix, customer mix, manufacturing costs, volume, sale discounts and charges for excess or obsolete inventory, to name a few. Many of these factors influence or are interrelated with other factors. Therefore, it is difficult to precisely quantify the impact of each item individually. The Company includes in cost of sales all the costs related to the sale of products in accordance with 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 profits includes management's best estimates of the reasons for the changes for the fiscal year ended May 29, 2005 compared to the same period last year as outlined in the table above.

### **Apio Value-Added**

The increase in gross profits for Apio's value-added specialty packaged vegetable business for the fiscal year ended May 29, 2005 compared to the same period last year was due to (1) a 16% increase in value-added sales during fiscal year 2005 and (2) improved manufacturing efficiencies through further automation of Apio's production process. These increases in gross profits were partially offset by produce shortages in March 2005 and the first half of April 2005 due to near record rains in the Western U.S. this past winter which reduced gross profits by approximately \$1.1 million.

### **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 profits during the fiscal year ended May 29, 2005 compared to the same period last year was primarily due to a sales mix change to higher margin fruit and vegetable products which increased fiscal year 2005 gross margins to 5.8% compared to gross margins of 5.0% for the same period last year.

### **Apio Tech**

The increase in gross profits for Apio Tech for the fiscal year ended May 29, 2005 compared to the same period last year was due to Apio only selling its proprietary banana packaging in fiscal year 2005 versus selling bananas in its banana packaging in fiscal year 2004 which resulted in significant gross profit losses.

### **Apio Service**

The decrease in Apio's service business gross profits during the fiscal year ended May 29, 2005 compared to the same period last year was directly attributable to lower volume sales in Apio's cooling operation and the sale of the domestic commodity vegetable business to Beachside Produce in June 2003.

### **Landec Ag**

The increase in gross profits for Landec Ag for the fiscal year ended May 29, 2005 compared to the same period last year was due to the increase in revenues, partially offset by higher royalty fees on corn seed hybrids with traits, such as genetics or certain chemicals, resulting in lower gross profits as a percentage of sales in fiscal year 2005 compared to the same period last year.

### **Corporate**

The decrease in gross profits for Corporate for the fiscal year ended May 29, 2005 compared to the same period last year was primarily due to the completion of two R&D contracts (UCB and a medical device collaboration) in early fiscal year 2004 which resulted in R&D gross profits decreasing \$152,000 in fiscal year 2005 compared to fiscal year 2004.

**Operating Expenses:**

	Fiscal Year Ended May 29, 2005	Fiscal Year Ended May 30, 2004	Change
(In thousands)			
<b>Research and Development:</b>			
<i>Apio</i>	\$ 831	\$ 1,246	(33)%
<i>Landec Ag</i>	647	857	(25)%
<i>Corporate</i>	1,065	1,349	(21)%
<b>Total R&amp;D</b>	<u>\$ 2,543</u>	<u>\$ 3,452</u>	(26)%
<b>Selling, General and Administrative:</b>			
<i>Apio</i>	\$ 12,354	\$ 12,498	(1)%
<i>Landec Ag</i>	7,857	7,017	12%
<i>Corporate</i>	3,201	2,769	16%
<b>Total S,G&amp;A</b>	<u>\$ 23,412</u>	<u>\$ 22,284</u>	5%

**Research and Development**

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

The decrease in research and development expenses for the fiscal year ended May 29, 2005 compared to the same period last year was primarily due to lower research and development expenses associated with (1) the Company's specialty packaging banana program as the focus of the program has shifted to market testing of the packaging technology with Apio's partner, Chiquita Brands International, (2) a greater shift of Landec Ag research and development personnel to production activities in fiscal year 2005 compared to fiscal year 2004 and (3) a reduction in staff at Corporate and lower facility related expenses in fiscal year 2005 compared to fiscal year 2004.

**Selling, General and Administrative**

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

The increase in selling, general and administrative expenses, excluding the \$713,000 gain on the sale of land at Apio which is netted against selling, general and administrative expenses, for the fiscal year ended May 29, 2005 compared to the same period last year was primarily due to an increase in selling and marketing expenses at Apio and Landec Ag in order to increase revenues.

**Other:**

	Fiscal Year Ended May 29, 2005	Fiscal Year Ended May 30, 2004	Change
	(In thousands)		
<b>Interest Income</b>	\$ 214	\$ 164	30%
<b>Interest Expense</b>	(414)	(811)	(49)%
<b>Minority Interest Expense</b>	(411)	(537)	(23)%
<b>Other (Expense)/ Income</b>	(4)	29	(114)%
<b>Total Other Expense</b>	<u>\$ (615)</u>	<u>\$ (1,155)</u>	(47)%

**Interest Income**

The increase in interest income for the fiscal year ended May 29, 2005 compared to the same period last year was primarily due to the increase in cash available for investing.

**Interest Expense**

The decrease in interest expense during the fiscal year ended May 29, 2005 compared to the same period last year was due to the Company using cash generated from operations to pay down debt and thus lowering interest expenses.

**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 in fiscal year 2005 compared to fiscal year 2004 was due to lower profits generated from Apio Cooling in fiscal year 2005.

**Other**

Other consists of non-operating income and expenses.

**Liquidity and Capital Resources**

As of May 28, 2006, the Company had cash and cash equivalents of \$20.5 million, a net increase of \$7.6 million from \$12.9 million at May 29, 2005.

**Cash Flow from Operating Activities**

Landec generated \$10.9 million of cash flow from operating activities during fiscal year 2006 compared to \$13.0 million during fiscal year 2005. The primary sources of cash during the fiscal year ended May 28, 2006 were from (1) net income and non-cash items, such as depreciation, of \$11.0 million and (2) increased current liabilities of \$4.5 million primarily due to increased royalty and technology fees in fiscal year 2006 at Landec Ag which are not due until fiscal year 2007. The primary uses of cash in operating activities were from (1) increased inventories, primarily seed corn at Landec Ag, of \$3.1 million and (2) increased accounts receivable of \$2.0 million primarily due to receivables at Heartland Hybrids which was acquired in August 2005.

**Cash Flow from Investing Activities**

Net cash used in investing activities for the year ended May 28, 2006 was \$5.5 million compared to \$5.2 million for the same period last year. The primary uses of cash from investing activities in fiscal year 2006 were for the purchase of the assets of Heartland Hybrids for \$3.9 million and the purchase of \$4.7 million of

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property and equipment primarily for the further automation of Apio's value-added facility. Net cash provided by investing activities was primarily from the net maturities of marketable securities of \$2.0 million.

### ***Cash Flow from Financing Activities***

Net cash provided by financing activities for the fiscal year ended May 28, 2006 was \$2.3 million compared to net cash used in financing activities of \$1.4 million for the same period last year. The primary sources of cash was from the sale of \$3.5 million of common stock to employees upon the exercise of stock options. The primary use of cash from financing activities during fiscal year 2006 was from the pay down of \$1.1 million of long-term debt.

### ***Capital Expenditures***

During the fiscal year ended May 28, 2006, Landec purchased vegetable processing equipment and expanded its processing facility to support the growth of Apio's value added business. These expenditures represented the majority of the \$4.7 million of equipment purchased.

### ***Debt***

On September 1, 2004, Apio entered into with Wells Fargo Bank N.A. ("Wells Fargo") a new \$10 million revolving line of credit that expires on August 31, 2006, a 12-month, \$4.8 million equipment line of credit, and a 36-month, \$1.2 million term note for equipment purchased under the equipment line of credit with Wells Fargo Business Credit (collectively the "Loan Agreement").

On November 1, 2005, Apio amended its revolving line of credit with Wells Fargo Bank N.A. that was scheduled to expire on August 31, 2006. The line was reduced from \$10.0 million to \$7.0 million and outstanding amounts under the line of credit now bear interest at either the prime rate less .25% or the LIBOR adjustable rate plus 1.75% (6.84% at May 28, 2006). The Loan Agreement contains certain restrictive covenants, which require Apio to meet certain financial tests, including minimum levels of net income, maximum leverage ratio, minimum net worth and maximum capital expenditures. Landec has pledged substantially all of the assets of Apio to secure the lines with Wells Fargo. At May 28, 2006, no amounts were outstanding under the revolving line of credit or the equipment line of credit. Apio has been in compliance with all loan covenants in the Loan Agreement since the inception of this loan.

Landec Ag has a revolving line of credit which allows for borrowings of up to \$7.5 million, based on Landec Ag's inventory levels. The interest rate on the revolving line of credit is the prime rate, (8.00% at May 28, 2006). The line of credit contains certain restrictive covenants, which, among other things, restrict the ability of Landec Ag to make payments on debt owed by Landec Ag to Landec. Landec Ag was in compliance with all of the loan covenants throughout fiscal year 2006. Landec has pledged substantially all of the assets of Landec Ag to secure the line of credit. At May 28, 2006, no amounts were outstanding under Landec Ag's revolving line of credit.

At May 29, 2005, Landec's total debt, including current maturities and capital lease obligations, was \$2.0 million and the total debt to equity ratio was 2% as compared to 4% at May 29, 2005. This debt was comprised of term debt and capital lease obligations. The amount of debt outstanding on the Company's revolving lines of credit fluctuates over time. Borrowings on Landec's lines of credit are expected to vary with seasonal requirements of the Company's businesses.

**Contractual Obligations**

The Company's material contractual obligations for the next five years and thereafter as of May 28, 2006, are as follows (in thousands):

Obligation	Due in Fiscal Year Ended May						
	Total	2007	2008	2009	2010	2011	Thereafter
Long-term Debt	\$ 1,968	\$ 1,968	\$ —	\$ —	\$ —	\$ —	\$ —
Capital Leases	50	50	—	—	—	—	—
Operating Leases	1,869	856	583	332	95	3	—
Licensing Obligation	600	100	100	100	100	100	100
Purchase Commitments	986	986	—	—	—	—	—
<b>Total</b>	<b>\$ 5,473</b>	<b>\$ 3,960</b>	<b>\$ 683</b>	<b>\$ 432</b>	<b>\$ 195</b>	<b>\$ 103</b>	<b>\$ 100</b>

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

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

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

The following table presents information about the Company's debt obligations and derivative financial instruments that are sensitive to changes in interest rates. The table presents principal amounts and related weighted average interest rates by fiscal year of expected maturity for the Company's debt obligations. The carrying value of the Company's debt obligations approximates the fair value of the debt obligations as of May 28, 2006.

Liabilities	2007	2008	2009	2010	2011	Thereafter	Total
Lines of Credit	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Avg. Int. Rate							
Long term debt, including current portion							
Variable Rate	\$2,018	\$ —	\$ —	\$ —	\$ —	\$ —	\$2,018
Avg. Int. Rate	5.90%						5.90%

**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 Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission, and to provide reasonable assurance that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Controls over Financial Reporting**

There were no changes in our internal controls over financial reporting during the quarter ended May 28, 2006 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 28, 2006. 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 28, 2006, 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 our assessment of our internal control over financial reporting, which is included herein.

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 Independent Registered Public Accounting Firm**

**The Board of Directors and Shareholders of Landec Corporation**

We have audited management's assessment, included in the accompanying Management Report on Internal Controls over Financial Reporting, that Landec Corporation maintained effective internal control over financial reporting as of May 28, 2006, 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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, 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, management's assessment that Landec Corporation maintained effective internal control over financial reporting as of May 28, 2006, is fairly stated, in all material respects, 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 as of May 28, 2006 and May 29, 2005, and the related statements of income, shareholders' equity, and cash flows for the years ended May 28, 2006, May 29, 2005 and May 30, 2004 of Landec Corporation and our report dated July 14, 2006 expressed an unqualified opinion thereon.

Ernst & Young LLP

San Jose, California  
July 14, 2006

**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 25, 2006 (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 25, 2006 (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 25, 2006 (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**

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 25, 2006 (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 25, 2006 (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

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<a href="#">Report of Ernst &amp; Young LLP, Independent Registered Public Accounting Firm</a>	44
<a href="#">Consolidated Balance Sheets at May 28, 2006 and May 29, 2005</a>	45
<a href="#">Consolidated Statements of Income for the Years Ended May 28, 2006, May 29, 2005 and May 30, 2004</a>	46
<a href="#">Consolidated Statements of Changes in Shareholders' Equity for the Years Ended May 28, 2006, May 29, 2005 and May 30, 2004</a>	47
<a href="#">Consolidated Statements of Cash Flows for the Years Ended May 28, 2006, May 29, 2005 and May 30, 2004</a>	48
<a href="#">Notes to Consolidated Financial Statements</a>	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](#)

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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  
Landec Corporation

We have audited the accompanying consolidated balance sheets of Landec Corporation and subsidiaries as of May 28, 2006 and May 29, 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the years in the periods ended May 28, 2006, May 29, 2005 and May 30, 2004. 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 28, 2006 and May 29, 2005, and the consolidated results of their operations and their cash flows for each of the three years in the periods ended May 28, 2006, May 29, 2005 and May 30, 2004, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Landec Corporation's internal control over financial reporting as of May 28, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated July 14, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Jose, California  
July 14, 2006

**LANDEC CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

	<u>May 28, 2006</u>	<u>May 29, 2005</u>
	(In thousands, except share and per share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 20,519	\$ 12,871
Marketable securities	—	1,968
Accounts receivable, less allowance for doubtful accounts of \$245 and \$313 at May 28, 2006 and May 29, 2005, respectively	17,637	15,405
Accounts receivable, related party	561	476
Inventory	13,958	9,917
Notes and advances receivable, net	376	419
Notes receivable, related party	14	89
Prepaid expenses and other current assets	1,637	2,042
Assets held for sale	—	1,190
Total current assets	54,702	44,377
Property and equipment, net	19,014	17,275
Goodwill, net	29,124	25,987
Trademarks, net	13,270	11,570
Other intangibles, net	860	58
Notes receivable	631	426
Notes receivable, related party	—	7
Other assets	1,424	375
Total Assets	<u>\$ 119,025</u>	<u>\$ 100,075</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 23,435	\$ 17,513
Related party payables	533	793
Accrued compensation	3,303	1,907
Other accrued liabilities	2,032	2,141
Deferred revenue	884	557
Current maturities of long term debt	2,018	548
Total current liabilities	32,205	23,459
Long term debt, less current maturities	—	2,540
Other liabilities	—	550
Minority interest	1,771	1,466
Total liabilities	33,976	28,015
Shareholders' equity:		
Common stock, \$0.001 par value; 50,000,000 shares authorized; 24,917,298 and 24,086,368 shares issued and outstanding at May 28, 2006 and May 29, 2005, respectively	126,288	121,950
Accumulated deficit	(41,239)	(49,890)
Total shareholders' equity	85,049	72,060
Total Liabilities and Shareholders' Equity	<u>\$ 119,025</u>	<u>\$ 100,075</u>

See accompanying notes.

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

	Year Ended May 28, 2006	Year Ended May 29, 2005	Year Ended May 30, 2004
(In thousands, except per share amounts)			
<b>Statement of Income Data:</b>			
Revenues:			
Product sales	\$ 225,404	\$ 201,020	\$ 185,664
Services revenue	—	—	2,083
Services revenue, related party	3,725	3,704	3,708
License fees	2,398	88	88
Research, development and royalty revenues	162	185	292
Royalty revenues, related party	264	233	257
Total revenues	231,953	205,230	192,092
Cost of revenue:			
Cost of product sales	184,345	164,027	153,354
Cost of product sales, related party	4,559	6,332	5,557
Cost of services revenue	3,005	2,899	3,390
Total cost of revenue	191,909	173,258	162,301
Gross profit	40,044	31,972	29,791
Operating costs and expenses:			
Research and development	3,042	2,543	3,452
Selling, general and administrative	27,979	23,412	22,284
Total operating costs and expenses	31,021	25,955	25,736
Operating income	9,023	6,017	4,055
Interest income	633	214	164
Interest expense	(452)	(414)	(811)
Minority interest expense	(529)	(411)	(537)
Other (expense)/income, net	(24)	(4)	29
Net income	\$ 8,651	\$ 5,402	\$ 2,900
Dividends on Series B preferred stock	—	—	(464)
Net income applicable to common shareholders	\$ 8,651	\$ 5,402	\$ 2,436
Basic net income per share	\$ 0.35	\$ 0.23	\$ 0.11
Diluted net income per share	\$ 0.32	\$ 0.21	\$ 0.12
Shares used in per share computation:			
Basic	24,553	23,705	21,396
Diluted	25,657	24,614	23,556

See accompanying notes.

**LANDEC CORPORATION**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

	Preferred Stock		Common Stock		Accumulated Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount		
	(In thousands, except share and per share amounts)					
Balance at May 25, 2003	160,881	\$ 5,531	21,107,517	\$110,100	\$ (57,728)	\$ 57,903
Dividends on Series B preferred stock	13,529	464	—	—	(464)	—
Issuance of common stock at \$0.58 to \$5.75 per share	—	—	330,401	746	—	746
Conversion of Series B preferred stock to common stock	(174,410)	(5,995)	1,744,102	5,995	—	—
Net income	—	—	—	—	2,900	2,900
Balance at May 30, 2004	—	—	23,182,020	116,841	(55,292)	61,549
Issuance of common stock at \$0.86 to \$7.20 per share	—	—	904,348	5,109	—	5,109
Net income	—	—	—	—	5,402	5,402
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	—	—	—	—	8,651	8,651
Balance at May 28, 2006	—	\$ —	24,917,298	\$126,288	\$ (41,239)	\$ 85,049

See accompanying notes

**LANDEC CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended May 28, 2006	Year Ended May 29, 2005	Year Ended May 30, 2004
	(In thousands)		
<b>Cash flows from operating activities:</b>			
Net income	\$ 8,651	\$ 5,402	\$ 2,900
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Depreciation and amortization	3,203	3,467	3,705
Write down of goodwill	—	—	129
Net (gain) loss on disposal of property and equipment	(120)	149	(57)
Minority interest	529	414	537
Investment in unconsolidated subsidiary	(1,311)	—	—
<b>Changes in assets and liabilities, net of effects from acquisitions and discontinued operations:</b>			
Accounts receivable, net	(1,968)	(532)	1,964
Inventory	(3,123)	1,310	250
Issuance of notes and advances receivable	(1,761)	(448)	(1,041)
Collection of notes and advances receivable	1,882	1,250	2,707
Prepaid expenses and other current assets	431	(515)	58
Accounts payable	3,685	2,553	1,020
Grower payables	—	—	(3,234)
Related party payables	(260)	363	(202)
Accrued compensation	1,396	337	347
Other accrued liabilities	(146)	(365)	(1,425)
Deferred revenue	(223)	(337)	(147)
<b>Net cash provided by operating activities</b>	<b>10,865</b>	<b>13,048</b>	<b>7,511</b>
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment	(4,746)	(3,658)	(3,393)
Acquisition of businesses, net of cash acquired	(3,860)	—	—
Decrease (increase) in restricted cash	—	—	2,382
Issuance of notes and advances receivable	(425)	—	(20)
Collection of notes and advances receivable	224	408	363
Proceeds from the sale of property and equipment	1,350	22	3
Purchase of marketable securities	(991)	(1,968)	—
Proceeds from maturities of marketable securities	2,959	—	—
<b>Net cash used in investing activities</b>	<b>(5,489)</b>	<b>(5,196)</b>	<b>(665)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from sale of common stock	3,378	5,109	746
Proceeds from the exercise of subsidiary options	105	50	103
Net change in other assets	254	(140)	(284)
Borrowings on lines of credit	14,904	59,441	136,521
Payments on lines of credit	(14,904)	(64,758)	(138,448)
Payments on long term debt	(1,136)	(1,791)	(2,658)
Proceeds from issuance of long term debt	—	1,200	87
Payments to minority interest	(329)	(550)	(154)
<b>Net cash provided by (used in) financing activities</b>	<b>2,272</b>	<b>(1,439)</b>	<b>(4,087)</b>
<b>Net increase in cash and cash equivalents</b>	<b>7,648</b>	<b>6,413</b>	<b>2,759</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>12,871</b>	<b>6,458</b>	<b>3,699</b>
<b>Cash and cash equivalents at end of year</b>	<b>20,519</b>	<b>\$ 12,871</b>	<b>\$ 6,458</b>
<b>Supplemental disclosure of cash flows information:</b>			
Cash paid during the period for interest	\$ 312	\$ 511	\$ 843
Cash paid during the period for income taxes	\$ —	\$ 50	\$ —
<b>Supplemental schedule of noncash investing and financing activities:</b>			
Sale of land and equipment for note receivable	\$ 380	\$ —	\$ 171
Issuance of Series B preferred stock as dividends to Series B preferred stockholders	\$ —	\$ —	\$ 464
Conversion of Series B preferred stock to common stock	\$ —	\$ —	\$ 5,995

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. In addition, the Company markets and distributes hybrid corn seed to farmers in the United States through its Landec Ag, Inc. ("Landec Ag") subsidiary and specialty packaged fresh-cut and whole produce to retailers and foodservice companies primarily, in the United States and Canada through its Apio, Inc. ("Apio") subsidiary.

***Basis of Presentation***

***Basis of Consolidation***

The consolidated financial statements comprise the accounts of Landec Corporation and its subsidiaries, Apio and Landec Ag. All material inter-company transactions and balances have been eliminated.

***Reclassifications***

Certain reclassifications have been made to prior period 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 accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported results of operations during the reporting period. Actual results could differ materially from those estimates.

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

***Concentrations of Risk***

Cash and cash equivalents, marketable securities, 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 are equal to 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. In addition, a majority of the hybrid corn varieties sold by Landec Ag are sourced from a single seed producer.

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

During the fiscal year ended May 28, 2006, sales to the Company's top five customers accounted for approximately 46% of total revenue, with the top customers, Costco Wholesale Corporation and Sam's Club from the Food Products Technology segment, accounted for approximately 16% and 14%, respectively, of total revenues. In addition, approximately 22% of the Company's total revenues were derived from product sales to international customers, none of whom individually accounted for more than 6% of total revenues. As of May 28, 2006, Costco Wholesale Corporation and Sam's Club represented approximately 20% and 14%, respectively, of total accounts receivable.

During the fiscal year ended May 29, 2005, sales to the Company's top five customers accounted for approximately 42% of total revenue, with the top customers, Costco Wholesale Corporation from the Food Products Technology segment, accounted for approximately 15% of total revenues. In addition, approximately 24% of the Company's total revenues were derived from product sales to international customers, none of whom individually accounted for more than 6% of total revenues. As of May 29, 2005, Costco Wholesale Corporation represented approximately 18% 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.

*Financial Instruments*

The Company's financial instruments are primarily composed of marketable debt securities, commercial-term trade payables and grower advances, notes receivable and lines of credit, 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 28, 2006.

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*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 changes in the Company's allowances for doubtful accounts are summarized in the following table.

	<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 30, 2004							
Allowance for doubtful accounts receivable and notes receivable	\$ 607	\$	276	\$	(423)	\$	460
Year ended May 29, 2005							
Allowance for doubtful accounts receivable and notes receivable	\$ 460	\$	80	\$	(182)	\$	358
Year ended May 28, 2006							
Allowance for doubtful accounts receivable and notes receivable	\$ 358	\$	47	\$	(135)	\$	270

*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.

Prior to November 1, 1999, the Company recognized noncancellable, nonrefundable license fees as revenue when received and when all significant contractual obligations of the Company relating to the fees had been met. Effective November 1, 1999, the Company changed its method of accounting for noncancellable, nonrefundable license fees to recognize such fees 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. The Company believes the change in accounting principle is preferable based on guidance provided in SAB 104. In the fiscal year ended October 29, 2000, the Company recorded a charge of \$1.9 million related to the cumulative effect of the change in accounting principle. The cumulative effect was initially recorded as deferred revenue and is being recognized as revenue over the research and development period or supply period commitment of the agreement. During the year ended October 29, 2000, the impact of the change in accounting was to increase the net loss by approximately \$1.5 million which was comprised of the \$1.9 million cumulative effect of the change as described above, net of \$374,000 of the related deferred revenue which was recognized as "recycled" revenue during 2000. "Recycled" revenue refers to revenue that had previously been recognized as licensing revenue in the Company's financial statements, but as a result of the Company's adoption of SAB 104, was reversed through a cumulative effect of a change in accounting in fiscal year 2000 and is now being recognized as revenue over the research and development period and/or the supply period commitment of the agreement, whichever is longer.

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

In July 2005, the Company amended its supply agreement with Alcon, Inc. to change the expiration date of the agreement from November 1, 2012 to May 28, 2006. In accordance with SAB 104, the entire amount of the deferred revenue of \$638,000 as of May 29, 2005, was recognized as "recycled" revenue during fiscal year 2006.

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.

***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. Short-term marketable securities consist of high quality corporate debt securities 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 29, 2005 (none at May 28, 2006) 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 2005. 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 2005. 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 28, 2006 and May 29, 2005 inventories consisted of (in thousands):

	May 28, 2006	May 29, 2005
Finished goods	\$ 10,017	\$ 6,132
Raw materials	3,764	3,655
Work in process	177	130
Inventory	<u>\$ 13,958</u>	<u>\$ 9,917</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*

The Company defers certain costs related to direct-response advertising of Landec Ag's hybrid corn seeds. Such costs are 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. The advertising expense for the Company for fiscal years 2006, 2005 and 2004 was \$1.6 million, \$2.2 million and \$2.1 million, respectively. The amount of deferred

LANDEC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

advertising included in prepaid expenses and other current assets at May 28, 2006 and May 29, 2005 was \$61,000 and \$192,000, respectively.

*Notes and Advances Receivable*

Apio has made advances to fruit growers for the development of orchards, to produce growers for crop and harvesting costs and to the buyer of the 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, except for development advances, these advances are paid off within the growing season (less than one year) from harvested crops. Development advances and 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 packing, cooling and distributing services for farms in which the Chief Executive Officer of Apio (the "Apio CEO") has a financial interest and purchases produce from those farms. Apio also purchases produce from Beachside Produce, LLC (formerly known as Apio Fresh), a related party, for sale to third parties and provides cooling and distribution services to Beachside Produce. Revenues, cost of product sales and the resulting receivables and payables are classified as related party in the accompanying financial statements as of May 28, 2006 and May 29, 2005 and for the fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004.

Apio leases, for approximately \$429,000 on an annual basis, agricultural land that is either owned, controlled or leased by the Apio CEO. Apio, in turn, subleases that land at cost to growers who are obligated to deliver product from that land to Apio for value added products. There is generally no net statement of operations impact to Apio as a result of these leasing activities but Apio creates a guaranteed source of supply for the value added business. Apio has loss exposure on the leasing activity to the extent that it is unable to sublease the land. For fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004, the Company subleased all of the land leased from the Apio CEO and received sublease income of \$554,000, \$1.0 million and \$1.3 million, 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 CEO is a 12.5% owner in Beachside Produce. During fiscal years 2006, 2005 and 2004, the Company recognized revenues of \$103,000, \$238,000 and \$890,000, respectively, from the sale of products to Beachside Produce and royalty revenues of \$264,000, \$233,000 and \$257,000, respectively, from the use by Beachside Produce of Apio's trademarks. The related accounts receivable is classified as related party in the accompanying Consolidated Balance Sheets as of May 28, 2006 and May 29, 2005.

In addition, the Apio CEO has a 6% ownership interest in Apio Cooling LP, a limited partnership in which Apio is the general partner with a 60% ownership interest. Included in minority interest as of May 28, 2006 and May 29, 2005 is \$237,000 and \$201,000, respectively, related to the Apio CEO's ownership interest.

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

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*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.

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. The Company capitalized \$226,000 and \$209,000 of software development costs during the fiscal years ended May 28, 2006 and May 29, 2005, respectively.

*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 2006, 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 using the services of an independent appraiser. 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 28, 2006.

*Equity Investment in Non-public Company*

The Company's equity investment in a non-public company is carried at cost, as 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 and then the carrying value of the investment is adjusted as necessary.

*Deferred Revenue*

Cash received in advance of services performed (principally revenues related to upfront license fees) or shipment of products (primarily hybrid corn seed) are recognized as a liability and recorded as deferred revenue. At May 28, 2006, approximately \$73,000 has been recognized as a liability for advances on future hybrid corn seed shipments, \$600,000 as a liability for deferred license fee revenues and \$211,000 for advances on ground lease payments from growers.

At May 29, 2005, approximately \$97,000 has been recognized as a liability for advances on future hybrid corn seed shipments, \$638,000 as a liability for deferred license fee revenues and \$372,000 for advances on ground lease payments from growers.

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*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 \$1.8 million at May 28, 2006 is comprised of \$1.5 million of limited partners' interest in Apio Cooling LP and \$296,000 of third party ownership in Apio and Landec Ag. The minority interest balance of \$1.5 million at May 29, 2005 is comprised of \$1.3 million of limited partners' interest in Apio Cooling LP and \$141,000 of third party ownership in Apio and Landec Ag.

*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 convertible preferred stock and 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 28, 2006	Fiscal Year Ended May 29, 2005	Fiscal Year Ended May 30, 2004
Numerator:			
Net income	\$ 8,651	\$ 5,402	\$ 2,900
Less: Minority interest in income of subsidiary	(556)	(294)	(116)
Net income for diluted net income per share	\$ 8,095	\$ 5,108	\$ 2,784
Denominator:			
Weighted average shares for basic net income per share	24,553	23,705	21,396
Effect of dilutive securities:			
Stock options	1,104	909	602
Convertible preferred stock	—	—	1,558
Total dilutive common shares	1,104	909	2,160
Weighted average shares for diluted net income per share	25,657	24,614	23,556
Diluted net income per share	\$ 0.32	\$ 0.21	\$ 0.12

Options to purchase 276,313, 622,452 and 1,370,178 shares of Common Stock at a weighted average exercise price of \$6.70, \$6.78 and \$6.31 per share were outstanding during fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004, 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.

*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,

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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**

The Company accounts for its stock option plans and its employee stock purchase plans in accordance with the provisions of the Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*.

The Company has elected to follow APB 25 in accounting for its employee stock options.

Under APB 25, no compensation expense is recognized in the Company's financial statements unless the exercise price of the Company's employee stock options is less than the market price of the underlying stock on the date of grant.

Pro forma information regarding net income and net income per share has been determined as if the Company had accounted for the Landec stock option plans under the fair value method and the Landec Ag stock plan and Apio stock plans under the minimum value method prescribed by Statement of Financial Accounting Standard No. 123 (SFAS No. 123). The fair value of options granted in fiscal years 2006, 2005 and 2004 reported below has been estimated at the date of grant using a Black-Scholes options pricing model with the following weighted average assumptions:

	Landec Employee Stock Options		
	Fiscal Year Ended	Fiscal Year Ended	Fiscal Year Ended
	May 28, 2006	May 29, 2005	May 30, 2004
Expected life (in years)	4.58	4.38	6.02
Risk-free interest rate	4.37%	3.70%	3.09%
Volatility	0.52	0.57	0.57
Dividend yield	0%	0%	0%

The assumptions used for the Landec stock options for the expected life, the risk-free interest rate and the dividend yield are the same assumptions used to determine the fair value of the Landec Ag and Apio options granted in the fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004. The fair value for Landec Ag and Apio options was estimated using the minimum value method since the stock of these subsidiaries is not publicly traded.

The Black-Scholes option valuation 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 28, 2006, May 29, 2005 and May 30, 2004 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 28, 2006, May 29, 2005 and May 30, 2004 was \$3.36, \$3.54 and \$2.89 per share, respectively. No stock options were granted above or below grant date market prices during the fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004. The weighted average estimated fair value of shares granted under the Landec Employee Stock Purchase Plan during the fiscal years ended



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

May 28, 2006, May 29, 2005 and May 30, 2004 was \$2.19, \$1.98 and \$0.88 per share, respectively. The weighted average estimated fair value of options granted under the Landec Ag Stock Plan during the fiscal year ended May 30, 2004 was \$0.23 per share. No options were granted under the Landec Ag Stock Plan in fiscal years 2006 and 2005. There were no grants under the Apio Stock Plan during fiscal years 2006, 2005 and 2004.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information follows (in thousands, except per share amounts):

	Year Ended May 28, 2006	Year Ended May 29, 2005	Year Ended May 30, 2004
Net income — as reported	\$ 8,651	\$ 5,402	\$ 2,900
Deduct:			
Stock-based employee expense determined under SFAS 123	(1,160)	(1,511)	(961)
Pro forma net income	\$ 7,491	\$ 3,891	\$ 1,939
Basic net income per share — as reported	\$ 0.35	\$ 0.23	\$ 0.11
Diluted net income per share — as reported	\$ 0.32	\$ 0.21	\$ 0.12
Basic pro forma net income per share	\$ 0.31	\$ 0.16	\$ 0.07
Diluted pro forma net income per share	\$ 0.27	\$ 0.15	\$ 0.08

The effects on pro forma disclosures of applying SFAS No. 123 are not likely to be representative of the effects on pro forma disclosures of future years due to the impact of granting options in future periods.

**Recent Accounting Pronouncements***Accounting for Stock-Based Compensation*

In December 2004, the FASB issued Statement No. 123 (revised 2004), *Share-Based Payment*, or SFAS No. 123R, which is a revision of SFAS No. 123, and supersedes APB Opinion 25. SFAS 123R requires all share-based payments to employees and directors, including grants of stock options, to be recognized in the statement of operations based on their fair values. On April 14, 2005, the SEC adopted a new rule that amended the compliance dates for SFAS 123R such that the Company is now allowed to adopt the new standard effective at the beginning of fiscal year 2007. The pro forma disclosures previously permitted under SFAS 123 will no longer be an alternative to financial statement recognition. As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB Opinion 25's intrinsic value method and, as such, recognizes no compensation cost for employee stock options.

Under SFAS 123R, the Company must determine the appropriate fair value model and related assumptions to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition methods include modified prospective and retroactive adoption options. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The modified prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive method would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. The Company has decided to adopt the modified prospective method. The Company is currently evaluating the requirements of

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

SFAS 123R as well as option valuation methodologies related to its stock option plans. The Company's preliminary estimate indicates that the effect of adopting SFAS 123R could result in a pre tax charge to net income of up to approximately \$500,000 in fiscal year 2007. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption.

**2. Purchase of Heartland Hybrids Assets**

On August 29, 2005, Landec Corporation, through its agricultural seed subsidiary, Landec Ag, Inc., acquired the assets of Heartland Hybrids, Inc. ("Heartland"), which is based in Dassel, MN, for \$6.0 million. The consideration at closing consisted of 152,186 shares of Landec Common Stock valued at \$960,000 and cash of \$3.69 million. In addition, the Company incurred \$130,000 in acquisition related expenses. The agreement also provides for future payments to the former owners of Heartland of up to \$1.35 million. These payments consist of a cash earn-out of \$1.2 million based on Heartland achieving certain financial targets for fiscal years 2006 and 2007 and a \$150,000 hold back for any post closing adjustments, \$100,000 of which was earned and paid in May 2006. In July 2006 the Company determined that approximately \$400,000 of the earn out was earned for fiscal year 2006 and will be subsequently paid and recorded as additional goodwill in the first quarter of fiscal year 2007. Heartland operations are included in Landec's consolidated results of operations commencing August 29, 2005. The purchase price has been allocated to the acquired assets and liabilities based on their relative fair market values, subject to final adjustments predominantly related to earn-out payments. These allocations are based on independent valuations and other studies.

The following is a summary of the purchase price allocation (in thousands):

Net assets and liabilities	\$ (757)
Customer Base	800
Trademark	1,700
Goodwill	3,137
	<u>\$ 4,880</u>

Under Statements of Financial Accounting Standards No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), 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. All of the goodwill generated from the acquisition of Heartland's assets is expected to be deductible for tax purposes. No pro forma information is deemed necessary as the operations of Heartland are immaterial to Landec's annual revenues and results of operations.

**3. License Agreements**

On December 23, 2005, Landec entered into an exclusive licensing agreement with a medical device company. This company paid Landec an upfront license fee of \$250,000 for the exclusive rights to use Landec's Intelimer® materials technology in a specific device field 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 \$1.31 million which represents a 19.9% ownership interest in the medical device company. The \$1.31 million is included in other assets in the accompanying Consolidated Balance Sheet. The \$1.56 million of value received under this agreement is recorded as licensing revenue 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 will

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

receive up to an additional \$1.6 million of license payments that will 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. 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 will be recognized as license revenue over a three year period beginning March 2006. In addition, in accordance with the agreement, Landec will receive 40% of the gross profits generated from the sale of products by Air Products occurring after March 14, 2007, that incorporate Landec's Intelimer materials. The Company recognized \$300,000 in license revenues under this agreement during the fourth quarter of fiscal year 2006.

**4. Licensing and Supply Agreement**

In July 2005, the Company amended the supply agreement with Alcon, Inc. to change the expiration date of the agreement from November 1, 2012 to May 28, 2006. As a result, all of the deferred revenue has been reclassified to current liabilities in the accompanying Consolidated Balance Sheets. In addition, in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition (a replacement of SAB 101)*, the entire amount of the deferred revenue of \$638,000 as of May 29, 2005, has been recognized as "recycled" revenue during fiscal year 2006.

**5. Purchase and Sale of Fruit Land**

On January 14, 2005, the Company entered into an agreement to purchase approximately 155 acres of fruit land from an individual for \$812,500. This amount was paid to the seller through the funding of an escrow account on March 23, 2005. In a separate unrelated transaction, on January 31, 2005, the Company entered into an agreement to sell approximately 45 acres of grape land to an individual for \$452,500. Upon entering into the agreement, the Company received \$28,000 in cash and promissory notes receivable for \$424,500. The sale closed on January 3, 2006. As of February 26, 2006, payments on the notes receivable totaled \$56,000 with the remaining balance to be paid from net profits from the sale of grapes produced from this property with a final payment due on December 31, 2009, if not previously paid off. Interest accrues at the prime rate and is payable quarterly. In another transaction which closed on January 17, 2006, the Company sold to an individual the remaining 110 acres for \$936,000 in cash, net of sales commissions. The Company recorded a gain of \$160,000 during fiscal year 2006 on these sales.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**6. Notes and Advances Receivable**

	<u>May 28, 2006</u>	<u>May 29, 2005</u>
Notes and advances receivable at May 28, 2006 and May 29, 2005 consisted of the following (in thousands):		
Note receivable due from buyer of fruit processing equipment in annual installments of \$98,143 plus interest at prime rate plus 1.0%, with final payment due October 20, 2009, secured by purchased assets(2)	\$ 413	\$ 507
Note receivable due from grower in annual installments in an amount equal to 50% of net profits realized by borrower from the sale of grapes produced from this property, plus interest at prime (8.00% at May 28, 2006), with final payment due December 31, 2009, secured by a deed of trust(2)	380	—
Advances to a grower under an agricultural sublease in semi-annual installments of \$214,500 through October 31, 2006, to be repaid at \$12,000 per week by withholding proceeds from crop produced on this property(1)	156	—
Note receivable from grower, with principal and interest at the prime rate plus 3%, payments to be withheld from proceeds derived from crop sales, due through October 31, 2005, secured by crops(1)	—	216
Note receivable due from grower in annual installments of \$33,437 plus interest at prime rate plus 1.0%, with final payment due December 31, 2007, unsecured(1)	67	117
Note receivable due from Beachside Produce (related party) in monthly installments of \$7,043 including interest at 5%, with final payment due June 30, 2006, secured by lien and security interest(2)	14	89
Notes receivable due from growers, with principal and interest of prime rate plus 1.75%, secured by their respective partnership interest in Apio Cooling LP. Payments to be deducted from distributions until notes are paid in full, with balances due December 31, 2008(1)	4	34
Note receivable due from buyer of fruit trademarks in annual installments of \$2,857 plus interest at prime rate plus 1.0%, with final payment due October 20, 2009(2)	12	15
Note receivable due from Beachside Produce (related party) in monthly installments of \$7,512 including interest at 5%, with final payment due June 30, 2005, secured by lien and security interest(2)	—	8
Gross notes and advances receivable	<u>1,046</u>	<u>986</u>
Less allowance for doubtful notes	<u>(25)</u>	<u>(45)</u>
Net notes and advances receivable	1,021	941
Less current portion of notes and advances receivable	<u>(390)</u>	<u>(508)</u>
Non-current portion of notes and advances receivable	<u>\$ 631</u>	<u>\$ 433</u>

(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 28, 2006, May 29, 2005 and May 30, 2004 was \$89,000, \$62,000 and \$137,000, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**7. Property and Equipment**

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

	Years of Useful Life	May 28, 2006	May 29, 2005
Land and building	15-30	\$ 11,757	\$ 11,051
Leasehold improvements	3-20	1,044	1,177
Computer, capitalized software, machinery, equipment and auto	3-7	22,581	20,403
Furniture and fixtures	5-7	448	428
Construction in process		2,171	142
Gross property and equipment		38,001	33,201
Less accumulated depreciation and amortization		(18,987)	(15,926)
Net property and equipment		<u>\$ 19,014</u>	<u>\$ 17,275</u>

Depreciation expense for the fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004 was \$3.2 million, \$3.4 million and \$3.4 million, respectively. Equipment under capital leases, which is the security for the related lease obligation, at May 28, 2006 and May 29, 2005 was \$103,000 and \$103,000, respectively. The related accumulated amortization for equipment under capital leases is \$58,000 and \$37,000, respectively. Amortization related to capitalized software was \$661,000, \$742,000 and \$989,000, respectively, for fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004. The unamortized computer software costs at May 28, 2006 and May 29, 2005 were \$2.1 million and \$1.8 million, respectively.

**8. Intangible Assets**

Changes in the carrying amount of goodwill for the fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004 by reportable segment, are as follows (in thousands):

	Food Products Technology	Agricultural Seed Technology	Total
Balance as of May 25, 2003	\$ 21,362	\$ 4,754	\$ 26,116
Goodwill disposed during the period	(129)	—	(129)
Balance as of May 30, 2004	21,233	4,754	25,987
Goodwill changes during the period	—	—	—
Balance as of May 29, 2005	21,233	4,754	25,987
Goodwill acquired during the period	—	3,137	3,137
Balance as of May 28, 2006	<u>\$ 21,233</u>	<u>\$ 7,891</u>	<u>\$ 29,124</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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

	May 28, 2006			May 29, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
<b><i>Unamortized Intangible Assets</i></b>						
Trademark	\$ 15,000	\$ (1,730)	\$ 13,270	\$ 13,300	\$ (1,730)	\$ 11,570
<b><i>Amortized Intangible Assets</i></b>						
Other	1,244	(384)	860	434	(376)	58
	<b>\$ 16,244</b>	<b>\$ (2,114)</b>	<b>\$ 14,130</b>	<b>\$ 13,734</b>	<b>\$ (2,106)</b>	<b>\$ 11,628</b>

Amortization expense, including amortization of other assets, for fiscal years 2006, 2005 and 2004 was \$0, \$103,000 and \$218,000 for Food Products Technology and \$8,000, \$1,000 and \$41,000 for Agricultural Seed Technology, respectively. Amortization expense, including amortization of other assets, for fiscal years ended May 29, 2006, May 29, 2005 and May 30, 2004 was \$8,000, \$104,000 and \$259,000, respectively.

## 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 28, 2006 has no outstanding preferred stock.

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

At May 28, 2006, the Company had 4,099,531 common shares reserved for future issuance under Landec stock option plans (3,976,054) and the employee stock purchase plan (123,477).

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.

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") are 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 has not received a previous grant, shall be granted a nonstatutory stock option to purchase 20,000 shares of Common Stock on the date on which the optionee first becomes a non-employee director of the Company. Thereafter, on the date of each annual meeting of the shareholders each non-employee director shall be granted an additional option to purchase 10,000 shares of Common Stock if, on such date, he or she shall have served on the Company's Board of Directors for at least six months prior

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

to the date of such annual meeting. The exercise price of the options is the fair market value of the Company's Common Stock on the date the options are granted. Options granted under this plan are exercisable and vest 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 are generally exercisable upon vesting and generally vest ratably over four years and are 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 may be no less than 100% of the fair market value of Landec's Common Stock on the date the options were granted. Options generally are exercisable upon vesting, generally vest ratably over four years and are 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 may 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 are exercisable upon vesting, generally vest ratably over four years and are subject to repurchase if exercised before being vested.

On April 15, 2005, the Board of Directors of the Company approved the accelerated vesting of all unvested options previously granted to employees under the Company's 1996 Stock Option Plans (collectively, the "Plans") which have an exercise price greater than \$6.25 (the "Acceleration") the closing price of the Company's Common Stock on April 15, 2005 in order to avoid recognizing an expense in future periods once the Company adopts SFAS 123R.

Pursuant to the Acceleration, options granted under the Plans to purchase 192,026 shares of the Company's common stock that would otherwise have vested at various times within three years from April 15, 2005 became fully vested. As a result of the Board's decision to approve the Acceleration, each option agreement underlying options subject to the Acceleration is deemed to be amended to reflect the Acceleration as of the effective date, but all other terms and conditions of each such option agreement remains in full force and effect. On the date of the Acceleration no compensation expense was recorded because the fair market value of the Company's Common Stock was below the exercise price of the options that were accelerated.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Activity under all Landec Stock Option Plans is as follows:

	Outstanding Options		
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price
Balance at May 25, 2003	1,179,856	4,054,244	\$ 4.63
Additional shares reserved	400,000	—	
Options granted	(161,000)	161,000	\$ 5.20
Options exercised	—	(152,659)	\$ 2.68
Options forfeited	139,824	(139,824)	\$ 4.77
Expired in 1988 Plan	(20,135)	—	
Balance at May 30, 2004	1,538,545	3,922,761	\$ 4.81
Options granted	(625,000)	625,000	\$ 6.54
Options exercised	—	(397,772)	\$ 3.80
Options forfeited	27,493	(27,493)	\$ 4.98
Balance at May 29, 2005	941,038	4,122,496	\$ 5.08
Additional shares reserved	861,038	—	
Options/ RSUs granted	(83,333)	83,333	\$ 6.69
Options exercised	—	(1,027,718)	\$ 5.83
Options forfeited	59,762	(59,762)	\$ 6.36
Terminated plans	(920,800)	—	
Balance at May 28, 2006	857,705	3,118,349	\$ 4.85

At May 28, 2006 and May 29, 2005 options to purchase 2,934,930 and 3,636,106 shares of Landec's Common Stock were vested, respectively. No options have been exercised prior to being vested.

The Company issued 833 restricted stock units (RSUs) during fiscal year 2006 at a price of \$7.53 per share. The restricted stock units vest at the end of three years. These units are included in the table above under options granted.

The following tables summarize information about Landec's options outstanding and exercisable at May 28, 2006 (excluding the 833 RSUs granted in fiscal year 2006).

Range of Exercise Prices	Options Outstanding		
	Number of Shares	Weighted Average Contractual Life (In Years)	Weighted Average Exercise Price
\$1.660 - \$2.950	315,834	6.64	2.28
\$3.180 - \$3.375	454,600	4.96	3.30
\$3.400 - \$3.800	325,177	4.84	3.59
\$4.094 - \$4.938	210,500	3.53	4.87
\$5.000 - \$5.000	735,600	1.59	5.00
\$5.250 - \$6.130	425,534	5.49	6.05
\$6.250 - \$7.625	650,271	6.32	6.84
\$1.660 - \$7.625	3,117,516	4.58	4.85



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Range of Exercise Prices	Options Exercisable	
	Number of Shares	Weighted Average Exercise Price
\$1.660 — \$2.950	271,376	2.28
\$3.180 — \$3.375	450,224	3.30
\$3.400 — \$3.800	321,113	3.59
\$4.094 — \$4.938	210,500	4.87
\$5.000 — \$5.000	735,600	5.00
\$5.250 — \$6.130	298,346	6.03
\$6.250 — \$7.625	647,771	6.84
\$1.660 — \$7.625	2,934,930	4.83

*Employee Stock Purchase Plan.* The Company has an employee stock purchase plan which permits 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. As of May 28, 2006, 851,523 shares have been issued under the Employee Stock Purchase Plan. The Employee Stock Purchase Plan was terminated on June 1, 2006.

*Landec Ag Stock Plan.* Under the 1996 Landec Ag Stock Plan, the Board of Directors of Landec Ag could grant stock purchase rights, incentive stock options or non-statutory stock options to employees and outside consultants. The exercise price of the stock purchase rights, incentive stock options and non-statutory stock options may be no less than 85%, 100% and 85%, respectively, of the fair market value of Landec Ag's common stock as determined by Landec Ag's Board of Directors. 2,000,000 shares were authorized to be issued under this plan. Options generally are exercisable upon vesting and generally vest ratably over four years and are subject to repurchase if exercised before being vested. The Landec Ag Stock Plan terminated on January 1, 2006.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The following table summarizes activity under the Landec Ag Stock Option.

	Options Available	Outstanding Options	
		Number of Shares	Weighted Average Exercise Price
Balance at May 25, 2003	228,918	1,445,000	\$ 0.41
Options granted	(10,000)	10,000	\$ 1.50
Options exercised	—	—	—
Options forfeited	195,150	(195,150)	\$ 0.50
Balance at May 30, 2004	414,068	1,259,850	\$ 0.41
Options granted	—	—	—
Options exercised	—	(503,895)	\$ 0.10
Options forfeited	165,855	(165,855)	\$ 1.00
Balance at May 29, 2005	579,923	590,100	\$ 0.71
Options granted	—	—	—
Options exercised	—	—	—
Options forfeited	52,313	(52,313)	\$ 0.94
Expired in Plan	(632,236)	—	—
Balance at May 28, 2006	—	537,787	\$ 0.69

At May 28, 2006, options to purchase 532,719 shares with an average exercise price of \$0.68 per share of Landec Ag's common stock were vested. For the options outstanding at May 28, 2006, 74,000 options were granted with an exercise price of \$0.10, 127,900 options were granted with an exercise price of \$0.20 and 335,887 were granted with an exercise price of \$1.00. As of May 28, 2006, the Company has 537,787 common shares reserved for future issuance under the Landec Ag stock option plan.

*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 may 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 may 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 28, 2006, options for two million shares had been granted at an exercise price of \$2.10 per share.

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 28, 2006, options for 268,695 shares are outstanding under the 2000 Plan at an exercise price of \$2.10 per share.

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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

	<u>Outstanding Options</u>		
	<u>Options Available</u>	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance at May 25, 2003	1,483,792	2,515,625	\$ 2.10
Options granted	—	—	—
Options exercised	—	(49,166)	\$ 2.10
Options forfeited	79,680	(79,680)	\$ 2.10
Balance at May 30, 2004	1,563,472	2,386,779	\$ 2.10
Options granted	—	—	—
Options exercised	—	—	—
Options forfeited	59,457	(59,457)	\$ 2.10
Balance at May 29, 2005	1,622,929	2,327,322	\$ 2.10
Options granted	—	—	—
Options exercised	—	(50,158)	\$ 2.10
Options forfeited	8,469	(8,469)	\$ 2.10
Balance at May 29, 2006	1,631,398	2,268,695	\$ 2.10

At May 28, 2006, options to purchase 2,268,695 shares of Apio common stock were vested. As of May 28, 2006, the Company has 3,900,093 common shares reserved for future issuance under the Apio stock option plans.

## 10. Debt

### *Revolving debt*

On September 1, 2004, Apio entered into with Wells Fargo Bank N.A. ("Wells Fargo") a new \$10 million revolving line of credit that expires on August 31, 2006, a 12-month, \$4.8 million equipment line of credit, and a 36-month, \$1.2 million term note for equipment purchased under the equipment line of credit with Wells Fargo Business Credit (collectively the "Loan Agreement"). At May 29, 2005, no amounts were outstanding under the revolving line of credit or the equipment line of credit.

On November 1, 2005, Apio amended its revolving line of credit with Wells Fargo Bank N.A. that was scheduled to expire on August 31, 2006. The line was reduced from \$10.0 million to \$7.0 million and outstanding amounts under the line of credit now bear interest at either the prime rate less .25% or the LIBOR adjustable rate plus 1.75% (6.84% at May 28, 2006). The Loan Agreement contains certain restrictive covenants, which require Apio to meet certain financial tests, including minimum levels of net income, maximum leverage ratio, minimum net worth and maximum capital expenditures. Landec has pledged substantially all of the assets of Apio to secure the lines with Wells Fargo. At May 28, 2006 and May 29, 2005, no amounts were outstanding under the revolving line of credit or the equipment line of credit.

Landec Ag has a revolving line of credit which allows for borrowings of up to \$7.5 million, based on Landec Ag's inventory levels. The interest rate on the revolving line of credit is the prime rate (8.00% at May 28, 2006). Landec has pledged substantially all of the assets of Landec Ag to secure the line of credit. At May 28, 2006 and May 29, 2005, no amounts were outstanding under this revolving line of credit.

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**Long-Term Debt**

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

	May 28, 2006	May 29, 2005
Note payable of Apio to a commercial finance company; due in monthly installments of \$12,795 including variable interest currently at 7.23% with final payment due December 2019	\$ 1,338	\$ 1,400
Note payable of Apio to a bank; due in monthly installments of \$33,333 including interest at 4.96% with final payment due August 2007	—	934
Note payable of Apio to a bank; due in monthly installments of \$7,739 including variable interest currently at 7.76% with final payment due December 2015	630	675
Capitalized lease obligations in monthly installments of \$1,979 with an interest rate of 5.90% with final payment due August 2008	50	79
	<u>2,018</u>	<u>3,088</u>
Less current portion	(2,018)	(548)
	<u>\$ —</u>	<u>\$ 2,540</u>

At May 28, 2006, all of the debt is classified as current as the Company repaid in June 2006 the notes payable balances due to escalating interest rates on the debt.

The term debt and revolving note agreements contains various financial covenants including minimum fixed coverage ratio, minimum current ratio, minimum adjusted net worth and maximum leverage ratios.

Landec has pledged substantially all of Apio's and Landec Ag's assets to secure their term debt.

**11. Income Taxes**

The Company recorded an income tax provision based on the federal alternative minimum tax rate in the amount of \$11,000 for the fiscal year ended May 28, 2006, \$6,000 for the fiscal year ended May 29, 2005 and \$50,000 for the fiscal year ended May 30, 2004. These amounts are included in other (expense)/income in the accompanying Consolidated Statements of Income.

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

	Year Ended May 28, 2006	Year Ended May 29, 2005	Year Ended May 30, 2004
Provision at U.S. statutory rate of 34%	\$ 2,949	\$ 1,839	\$ 1,003
State income taxes, net of federal benefit	506	315	172
Change in valuation allowance	(3,788)	(2,017)	(703)
Tax credit carryforwards	375	(200)	(396)
Other	(31)	69	(26)
Total	<u>\$ 11</u>	<u>\$ 6</u>	<u>\$ 50</u>

As of May 28, 2006, the Company had federal and state net operating loss carryforwards of approximately \$42.0 million and \$9.7 million, respectively. These losses expire in different periods through 2025, if not utilized. The Company also had federal and state tax credit carryforwards of approximately \$1.3 million and \$1.2 million, respectively. The research and development tax credit carryforwards expire in different periods

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

through 2026 for federal purposes and have an unlimited carryforward period for state purposes. The other state tax credit carryforwards expire in different periods through fiscal year 2013.

Utilization of the net operating losses and credits may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986. The annual limitation may result in the expiration of net operating losses and credits before utilization.

Significant components of the Company's deferred tax assets are as follows (in thousands):

<b>Deferred Tax Assets:</b>	<b>May 28, 2006</b>	<b>May 29, 2005</b>
Net operating loss carryforwards	\$ 14,900	\$ 16,700
Research and AMT credit carryforwards	2,100	2,300
Capitalized research and development	100	100
Other — net	(4,700)	(3,200)
Net deferred tax assets	12,400	15,900
Valuation allowance	(12,400)	(15,900)
Net deferred tax assets	<u>\$ —</u>	<u>\$ —</u>

Included in the other net deferred tax assets is approximately \$5.8 million of deferred tax liabilities that primarily relate to book/tax basis differences in fixed assets and intangibles.

Due to the Company's limited tax basis earnings history, the net deferred tax asset has been fully offset by a valuation allowance. The change in the valuation allowance was a decrease of \$3.5 million, an increase of \$700,000 and a decrease of \$1.3 million for the fiscal years ended May 28, 2006, May 29, 2005 and May 30, 2004, respectively. Approximately \$840,000 of the valuation allowance for deferred tax assets as of May 28, 2006 relates to benefits of stock option deductions which, when recognized, will be allocated directly to contributed capital.

## 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 2010. The approximate future minimum lease payments under these operating leases, excluding farmland leases, at May 28, 2006 are as follows (in thousands):

	<b>Amount</b>
FY2007	\$ 856
FY2008	583
FY2009	332
FY2010	95
FY2011	3
	<u>\$ 1,869</u>

Rent expense for operating leases, including month to month arrangements was \$1.4 million for the fiscal year ended May 28, 2006, \$1.6 million for the fiscal year ended May 29, 2005 and \$1.4 million for the fiscal year ended May 30, 2004.

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Land Leases***

Landec, through its Apio subsidiary, also leases farmland under various non-cancelable leases expiring through October 2006. Landec subleases substantially all of the farmland to growers on an annual basis. The subleases are generally non-cancelable and expire through October 2006. The approximate future minimum leases and sublease amounts receivable under farmland leases at May 28, 2006 are \$207,000 for fiscal year 2007.

Rent income for land leases net of sublease rents, including month to month arrangements was \$25,000 for the fiscal year ended May 28, 2006. Rent expense for land leases net of sublease rents, including month to month arrangements was \$51,000 for the fiscal year ended May 29, 2005 and \$16,000 for the fiscal year ended May 30, 2004.

***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 \$506,000 at May 28, 2006 and \$255,000 at May 29, 2005.

***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 2005 through 2012.

***Purchase Commitments***

At May 28, 2006, the Company was committed to purchase \$986,000 of produce during fiscal year 2007 in accordance with contractual terms. Payments of \$704,000 were made in fiscal year 2006 under this arrangement.

**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. 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 28, 2006, May 29, 2005 and May 30, 2004, the Company contributed \$335,000, \$294,000 and \$287,000, respectively, to the Landec Plan.

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**14. Business Segment Reporting**

Landec operates in two business segments: the Food Products Technology segment and the Agricultural Seed Technology segment. The Food Products Technology segment markets and packs produce and specialty packaged fresh-cut vegetables that incorporate the Intelimer packaging technology for the fresh-cut and whole produce industry through its Apio subsidiary. The Agricultural Seed Technology segment markets and distributes hybrid seed corn to the farming industry and is selling seed coatings using Landec's proprietary Intelimer polymers through Landec Ag and other seed companies. The Corporate and Other segment includes the operations from the Company's Technology Licensing/ Research and Development business and corporate operating expenses. The Food Products Technology and Agricultural Seed Technology segments include charges for corporate services allocated from the Corporate and Other segment. Corporate and Other amounts include non-core operating activities, corporate operating costs and net interest expense. Virtually all of the Company's international sales are to Asia. Operations and identifiable assets by business segment consisted of the following (in thousands):

	<b>Food Products Technology</b>	<b>Agricultural Seed Technology</b>	<b>Corporate and Other</b>	<b>Total</b>
<b>Fiscal Year Ended May 28, 2006</b>				
Net sales	\$ 194,816	\$ 34,096	\$ 3,041	\$ 231,953
International sales	\$ 50,337	\$ —	\$ —	\$ 50,337
Gross profit	\$ 26,853	\$ 10,439	\$ 2,752	\$ 40,044
Net income (loss)	\$ 9,128	\$ (1,387)	\$ 910	\$ 8,651
Identifiable assets	\$ 83,531	\$ 32,613	\$ 2,881	\$ 119,025
Depreciation and amortization	\$ 2,572	\$ 533	\$ 98	\$ 3,203
Capital expenditures	\$ 4,263	\$ 439	\$ 44	\$ 4,746
Interest income	\$ 502	\$ 75	\$ 56	\$ 633
Interest expense	\$ 300	\$ 152	\$ —	\$ 452
Income tax expense (benefit)	\$ —	\$ —	\$ —	\$ —
<b>Fiscal Year Ended May 29, 2005</b>				
Net sales	\$ 179,157	\$ 25,648	\$ 425	\$ 205,230
International sales	\$ 48,773	\$ —	\$ —	\$ 48,773
Gross profit	\$ 22,195	\$ 9,448	\$ 329	\$ 31,972
Net income (loss)	\$ 5,621	\$ (316)	\$ 97	\$ 5,402
Identifiable assets	\$ 72,511	\$ 22,711	\$ 4,853	\$ 100,075
Depreciation and amortization	\$ 2,890	\$ 472	\$ 105	\$ 3,467
Capital expenditures	\$ 3,134	\$ 426	\$ 98	\$ 3,658
Interest income	\$ 130	\$ 57	\$ 27	\$ 214
Interest expense	\$ 305	\$ 109	\$ —	\$ 414
Income tax expense (benefit)	\$ —	\$ —	\$ —	\$ —
<b>Seven Months Ended May 30, 2004</b>				
Net sales	\$ 167,886	\$ 23,641	\$ 565	\$ 192,092
International sales	\$ 48,679	\$ —	\$ —	\$ 48,679
Gross profit	\$ 20,231	\$ 9,086	\$ 474	\$ 29,791
Net income (loss)	\$ 3,232	\$ (241)	\$ (91)	\$ 2,900
Identifiable assets	\$ 72,088	\$ 19,722	\$ 1,197	\$ 93,007
Depreciation and amortization	\$ 3,110	\$ 484	\$ 111	\$ 3,705
Capital expenditures	\$ 2,997	\$ 320	\$ 76	\$ 3,393
Interest income	\$ 148	\$ 9	\$ 7	\$ 164
Interest expense	\$ 683	\$ 128	\$ —	\$ 811
Income tax expense (benefit)	\$ —	\$ —	\$ —	\$ —

**LANDEC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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

The following is a summary of the unaudited quarterly results of operations for fiscal years 2006, 2005 and 2004 (in thousands, except for per share amounts):

<b>FY 2006</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>	<b>FY 2006</b>
Revenues	\$ 49,705	\$ 53,712	\$ 57,249	\$ 71,287	\$231,953
Gross profit	\$ 6,590	\$ 7,089	\$ 11,415	\$ 14,950	\$ 40,044
Net income (loss)	\$ (521)	\$ (1,037)	\$ 3,514	\$ 6,695	\$ 8,651
Net income/(loss) per basic share	\$ (0.02)	\$ (0.04)	\$ 0.14	\$ 0.27	\$ 0.35
Net income/(loss) per diluted share	\$ (0.02)	\$ (0.04)	\$ 0.13	\$ 0.24	\$ 0.32
<b>FY 2005</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>	<b>FY 2005</b>
Revenues	\$ 46,854	\$ 50,672	\$ 51,532	\$ 56,172	\$205,230
Gross profit	\$ 5,741	\$ 5,997	\$ 9,242	\$ 10,992	\$ 31,972
Net income (loss)	\$ (692)	\$ (808)	\$ 2,293	\$ 4,609	\$ 5,402
Net income/(loss) per basic share	\$ (0.03)	\$ (0.03)	\$ 0.10	\$ 0.19	\$ 0.23
Net income/(loss) per diluted share	\$ (0.03)	\$ (0.03)	\$ 0.09	\$ 0.17	\$ 0.21
<b>FY 2004</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>	<b>FY 2004</b>
Revenues	\$ 41,803	\$ 43,265	\$ 48,587	\$ 58,437	\$192,092
Gross profit	\$ 6,082	\$ 5,030	\$ 7,447	\$ 11,232	\$ 29,791
Net income (loss)	\$ (624)	\$ (1,583)	\$ 724	\$ 4,383	\$ 2,900
Net income/(loss) per basic share	\$ (0.03)	\$ (0.08)	\$ 0.03	\$ 0.20	\$ 0.11
Net income/(loss) per diluted share	\$ (0.03)	\$ (0.08)	\$ 0.03	\$ 0.17	\$ 0.12



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(b) Index of Exhibits.

<b>Exhibit Number:</b>	<b>Exhibit Title</b>
2.4	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.
2.5	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 3.1 to the Registrant's Current Report on Form 8-K dated May 19, 2005.
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.
10.3*	1995 Employee Stock Purchase Plan, as amended, and form of Subscription Agreement, incorporated herein by reference to Exhibit 10.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 31, 1996.
10.5*	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.
10.6	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.
10.15*	1996 Landec Ag Stock Option Plan and form of Option Agreements, incorporated herein by reference to Exhibit 10.15 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 31, 1996.
10.16*	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.
10.17*	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.
10.18*	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.
10.25*	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.
10.26*	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.
10.28*	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 filed for the fiscal year ended October 29, 2000.

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<b>Exhibit Number:</b>	<b>Exhibit Title</b>
10.29	Credit Agreement between Landec Ag, Inc. and Old National Bank dated as of June 5, 2000, as amended, incorporated herein by reference to Exhibit 10.29 to the Registrant's Annual Report on Form 10-K for the fiscal year ended October 29, 2000.
10.30*	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.
10.35*	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.
10.45*	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.
10.46	Fourth Amendment to Credit Agreement dated as of May 15, 2003, incorporated herein by reference to Exhibit 10.46 to the Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended April 27, 2003.
10.47	Non-Competition 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 2.2 to the Registrant's Current Report on Form 8-K dated July 3, 2003.
10.48	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.
10.53*	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.
10.54+	2007 Cash Bonus Plan.
10.55+	Director Compensation Schedule.
10.56	Form of Notice regarding acceleration of stock option vesting , incorporated herein by reference to Exhibit 10.56 to the Registrant's Annual Report on Form 10-K for the fiscal year ended May 29, 2005.
10.59	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.
10.60	Fifth Amendment to Credit Agreement dated as of October 7, 2004, incorporated herein by reference to Exhibit 10.58 to the Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended November 27, 2005.
10.61	Credit Agreement dated as of October 7, 2005, incorporated herein by reference to Exhibit 10.59 to the Registrant's Annual Report on Form 10-Q for the fiscal quarter ended November 27, 2005.
10.63+#	License and research and development agreement between the Registrant and Air Products and Chemical, Inc. dated March 14, 2006.
10.64	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.
10.65	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.
10.66+	Form of Notice of Stock Option Grant and Stock Option Agreement for 2005 Stock Incentive Plan.
10.67+	Form of Stock Unit Agreement for 2005 Stock Incentive Plan.
10.68	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.
21.1	Subsidiaries of the Registrant

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	<b>Subsidiary</b>	<b>State of Incorporation</b>
	Landec Ag, Inc.	Delaware
	Apio, Inc.	Delaware
23.1+	Consent of Independent Registered Public Accounting Firm.	
24.1+	Power of Attorney — See page 76.	
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(c) 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 separately filed with the SEC.



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<u>Signature</u>	<u>Title</u>	<u>Date</u>
<hr/> <i>/s/ Stephen E. Halprin</i> <hr/> Stephen E. Halprin	Director	July 27, 2006
<hr/> <i>/s/ Richard S. Schneider</i> <hr/> Richard S. Schneider	Director	July 27, 2006
<hr/> <i>/s/ Kenneth E. Jones</i> <hr/> Kenneth E. Jones	Director	July 27, 2006

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Exhibit Title</b>
10.54	2007 Cash Bonus Plan.
10.55	Director Compensation Schedule.
10.63	License and research and development agreement between the Registrant and Air Products and Chemical, Inc. dated March 14, 2006.
10.66	Form of Notice of Stock Option Grant and Stock Option Agreement for 2005 Stock Incentive Plan.
10.67	Form of Stock Unit Agreement for 2005 Stock Incentive Plan.
23.1	Consent of Independent Registered Public Accounting Firm.
24.1	Power of Attorney. See page 76.
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.

**2007 Cash Bonus Plan**

On June 15, 2006, the Board of Directors (the "Board") of Landec Corporation (the "Company") approved the performance criteria and structure for cash bonuses that may be awarded to employees of the Company and its subsidiaries for the 2007 fiscal year (the "Plan"). These arrangements are not contained in a formal written plan, but a summary of the manner in which cash bonuses will be determined for fiscal year 2007 is set forth below.

Employees of the Company and its subsidiaries may earn cash bonuses based upon the achievement of separate income and revenue targets for the Company, Apio, Inc. and Landec Ag, Inc. Bonuses are calculated by multiplying a percentage of each participant's base salary by the percentage of the aggregate performance goals that are attained. The percentage of base salary used to determine each participant's cash bonus payment ranges from 40% to 100% of base salary for executive officers (up to 198% for Nick Tompkins, Chief Executive Officer of Apio) and from 10% to 79% for other employees. Participants must attain a minimum percentage of the aggregate performance goals to receive a bonus under the Plan. Also, participants must be employed by the Company or one of its subsidiaries at the time that bonuses are paid. Bonus payments, if any, will be made in single lump sum cash payments as soon as practicable after the end of the Company's fiscal year.

LANDEC CORPORATION  
DIRECTOR COMPENSATION SCHEDULE

Non-employee Directors (the "Directors") will receive the annual retainers, meeting fees, meeting expenses and equity-based awards described below as compensation for serving as a member of the Board of Directors.

**Annual Retainers**

*Board Retainer* - Each Director will receive an annual board retainer of \$20,000 to be paid in quarterly installments of \$5,000.

*Compensation Committee Chairman Retainer* - Each Director who serves as the Chairman of the Compensation Committee will receive an annual retainer of \$5,000.

*Audit Committee Retainer* - Each Director who serves on the Audit Committee will receive an annual retainer of \$10,000, with the Chairman receiving an annual retainer of \$15,000.

*Lead Independent Director Retainer* - Each Director who serves as the Lead Independent Director of the non-employee executive sessions of the Board shall receive an annual retainer of \$10,000.

**Meeting Fees**

Each Director will receive \$1,000 for each regular meeting, adjourned regular meeting or special meeting of the Board attended in person by the Director (\$500 if attended by phone), \$500 for each regular meeting, adjourned regular meeting or special meeting of a Committee attended in person by the Director as a member of the Committee, and \$1,000 for each shareholder meeting attended by the Director.

**Meeting Expenses**

Reasonable out-of-pocket expenses incurred by a Director to attend Board meetings, Committee meetings or shareholder meetings in his or her capacity as a Director will be reimbursed.

**Equity Compensation Awards**

On June 15, 2006, Directors were granted options to purchase 5,000 shares of the Company's Common Stock and 1,667 restricted stock units pursuant to the terms of the Company's 2005 Stock Incentive Plan. The stock options are fully vested and exercisable on the date of grant and have an exercise price equal to the fair market value of the Common Stock on the date of grant. The restricted stock units will vest on the first anniversary of the grant date.



**LICENSE AND RESEARCH AND DEVELOPMENT AGREEMENT**

This License and Research and Development Agreement (this "Agreement") is entered into as of March 14, 2006 (the "Effective Date"), by and between LANDEC CORPORATION, a California corporation (together with its Affiliates referred to herein as "Landec"), and AIR PRODUCTS AND CHEMICALS, INC., an entity organized and existing under the laws of Delaware (together with its Affiliates referred to herein as "APD"). APD and Landec are sometimes referred to herein individually as a "Party" and collectively as the "Parties."

**Background**

Landec has certain proprietary know-how and technology relating to certain polymer materials. APD develops, manufactures and distributes, among other things, gases and specialty chemicals to diversified markets and geographies. The Parties desire that Landec and APD collaborate using Landec's know-how and technology to develop certain personal care, latent catalyst, cleaning and nonwoven products using Landec's know-how and technology and to license to APD certain of that know-how and technology, for APD to exploit, as more fully described herein.

The Parties agree as follows:

**Agreement**

1. Certain Definitions. For the purposes of this Agreement, the capitalized words and phrases defined in the preamble of this Agreement have the respective meanings set forth therein, and the following capitalized words and phrases have the meanings ascribed to them below:

1.1 "Adhesives" shall mean a viscoelastic material that remains permanently tacky and will adhere to a wide variety of solid surfaces.

1.2 "Affiliate" shall mean with respect to a party: (i) any company at least fifty percent (50%) of whose issued and voting capital is owned or controlled, directly or indirectly, by said party, or (ii) any company which owns or controls, directly or indirectly, at least fifty percent (50%) of the issued and voting capital of said party, or (iii) any company owned or controlled, directly or indirectly, to the extent of at least fifty percent (50%) of the issued and voting capital, by any of the foregoing.

1.3 "Ag Field" shall mean: (a) the treatment, coating, sale and/or use of seeds or agricultural products including without limitation corn, soybean, cotton and the like for farming, ornamental and/or other uses, (b) tubers, seeds and/or plant grafts, (c) all other crops, and (d) all other fruits, vegetables, flowers and the like.

1.4 "APD Fields" shall mean the Exclusive Fields together with the Reserved Fields provided, however, that the APD Fields shall exclude the Excluded Fields.

1.5 “APD Improvements” shall only mean Improvements to the Patent Properties or the Existing Know-How created solely by APD without any assistance or involvement by Landec. APD Improvements shall exclude Improvements by those individuals without knowledge of any of the Existing Know-How or any portion of the Intelimer Instruction.

1.6 “APD IP” shall mean (i) the APD Improvements and (ii) the Joint Use Improvements in the APD Fields.

1.7 “Buy-Out Option” shall have the meaning given to it in Section 6.5.

1.8 “Commercialized” or “Commercialize” shall mean that Net Sales of Products in a particular Reserved Field have exceeded one hundred thousand dollars (\$100,000) or more in any given calendar year.

1.9 “Direct Profits” shall mean Net Sales arising out of sale or exploitation of Products (or \*\*\* products as provided in Sections 4 and 6.2) minus the following: (a) container purchase costs; (b) freight and warehouse costs; (c) raw material costs; (d) variable manufacturing costs including additional toll charges for third party processors; (e) fixed manufacturing costs (including depreciation) allocated in the same manner that APD allocates such fixed manufacturing costs for its general accounting purposes and (f) supply chain costs that are directly related to the manufacture and internal product management of Products, as sourced from third party processors or in-house production.

1.10 “Excluded Fields” shall mean Pharmaceuticals, the Food Field, the \*\*\* and Adhesives.

1.11 “Exclusive Fields” shall mean products for: (a) personal care, which are not regulated by the FDA, including without limitation i) cosmaceutical products (which may be regulated by the FDA), ii) sunscreen products which are regulated by the FDA and iii) non-pharma transdermal even if applied via an adhesive system ) (collectively the “Personal Care Field”), (b) Thermoset Latent Catalysts, (c) household, industrial and institutional cleaning, excluding floor finishes (e.g. and not by way of limitation, polymers and polymer-based formulations used in the manufacture of hard surface cleaners, equipment cleaning, vehicle cleaning, laundry cleaning, cleaning for food & beverage institutions), and (d) disposable nonwovens (e.g., and not by way of limitation, polymers and polymer-based formulations used in the manufacture of disposables such as paper towels, industrial wipes, surgical gowns, diapers, similar hygiene products, among other disposable nonwoven products).

1.12 “Existing Know-How” shall mean all information relating to the Landec Intelimer Materials which is necessary or useful to the manufacture, use or sale of the Products, which on the Effective Date Landec owns or is free to license to APD and shall include, but not be limited to, the Intelimer Instruction. For the avoidance of doubt, the Existing Know-How shall constitute at least part of the Proprietary Information of Landec or Landec’s licensor(s) if any.

1.13 “Food Field” shall include, without limitation, the following: the packaging, including bulk, pallet and container packaging, of any food related products including without limitation fresh produce, such as fruits and vegetables, flowers, meat, fish and the like.

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\* Certain information on this page has been omitted and filed separately with the Commission. Confidential treatment has been requested with respect to the omitted portions.

1.14 “Governmental Authority” shall mean any government or agency, instrumentality or other subdivision thereof, including courts and tribunals, and the states, provinces and other subdivisions thereof.

1.15 “Improvements” shall mean all improvements to the Patent Properties or the Existing Know-How developed by either Party hereunder (solely or jointly by the Parties or, subject to Section 2.5, jointly with third parties) including but not limited to inventions, patents, know-how, trade secrets and confidential information which is recorded, developed, conceived of, created and/or reduced to practice during the Term.

1.16 “Infringement Notice” shall have the meaning set forth in Section 9.2 of this Agreement.

1.17 “Intelimer Instruction” shall have the meaning given to it in Exhibit B.

1.18 “Joint Use Improvements” shall mean Improvements created jointly by the Parties which result in one or more patent applications or issued patents covering a field of use (as opposed to a process or composition of matter).

1.19 “Landec Field” shall mean all fields other than the APD Fields.

1.20 “Landec Improvements” shall mean Improvements: (i) created solely by Landec without any assistance or involvement by APD; (ii) created jointly by APD and Landec or otherwise using the resources of both Parties, (iii) created by Landec and a third party provided that such improvements are licensable to APD, or (iv) acquired, or licensed by Landec and sublicensable to APD.

1.21 “Landec IP” shall mean the Licensed Technology and the Joint Use Improvements in the Landec Field.

1.22 “Landec Intelimer Materials” shall mean any of Landec’s proprietary temperature-responsive materials exhibiting a pre-defined thermal transition.

1.23 “Laws” shall mean laws, statutes, ordinances, rules, regulations, judgments or decrees administered, promulgated or issued by any Governmental Authority.

1.24 “Licensed Technology” shall mean the Patent Properties, the Existing Know-How and any Landec Improvements.

1.25 “Licensed Trademarks” shall mean the mark “INTELIMER”, including all registered and common law rights thereto and goodwill associated therewith, and any foreign equivalent or representation thereof where Landec has the rights to such mark. Exhibit C sets forth the territories in which the mark is currently registered.

1.26 “Minimum Payments” shall have the meaning given to it in Section 6.2.

1.27 "Net Sales" shall mean all money received from sales of products minus amounts paid to unaffiliated third parties (distributors, agents and the like) for sales costs directly related to the sale of such products.

1.28 "Patent Properties" shall mean the patents and patent applications listed on Exhibit A covering the Landec Intelimer Materials, the inventions described and claimed therein, and any continuations, continuations-in-parts, divisionals, reexamination certificates, reissuances, renewals or extensions thereof or related by a priority claim therewith, and any and all foreign patents, utility models (i.e., petty patents), registrations and patent applications corresponding thereto (and any extension, reissue, reexamination or substitute of any of the foregoing, which will be automatically incorporated in and added to this Agreement and shall periodically be added to Exhibit A).

1.29 "Person" shall mean an individual or entity of any kind, including a Governmental Authority.

1.30 "Personal Care Field" shall have the meaning given to it in Section 1.11.

1.31 "Pharmaceuticals" shall mean therapeutics requiring FDA approval.

1.32 "Product" shall mean a product for use in the APD Fields (i) that is developed using the Licensed Technology or an Improvement; (ii) which comprises any of the Landec Intelimer Materials, or (iii) that is covered by any of the Patent Properties.

1.33 "Proprietary Information" of a disclosing Party disclosed to the receiving Party hereunder shall mean any confidential information relating to the disclosing Party's business and/or technology and which is labeled as confidential or proprietary or identified in writing as confidential or proprietary.

1.34 "Proprietary Rights" shall mean all intellectual property rights whether registrable or not of any sort anywhere in the world.

1.35 "R&D Period" shall have the meaning set forth in Section 3.1.

1.36 "Reserved Fields" shall initially mean the fields of (i) architectural and industrial coatings (excluding powder coatings) and (ii) electronics (e.g. processing materials for semiconductor component manufacturing, battery materials or flat panel displays); or such other fields as replace these initial Reserved Fields in accordance with Section 5.

1.37 "Term" shall have the meaning given to it in Section 10.1.

1.38 "Thermoset Latent Catalysts" shall mean Landec Intelimer Materials used as catalysts, effectors, activators, cross-linkers, initiators and/or precursors thereof to enhance or inhibit polymerization.

1.39 "Work Plan" shall mean the work plan that is attached hereto as Exhibit B, which is incorporated by reference herein, as amended, modified, extended or replaced upon mutual agreement of the Parties.

1.40 “Year” shall mean a year of this Agreement (i.e. Year 1 shall mean that period commencing on the Effective Date and ending on the first anniversary of the Effective Date).

## 2. Licenses

2.1 Technology License to APD. Subject to the terms and conditions of this Agreement, Landec hereby grants to APD an exclusive, worldwide, non-transferable, non-sublicensable, license for all rights to use, make, have made, market, sell, offer for sale, import and export and otherwise exploit the Licensed Technology within the APD Fields; provided, however, that Landec shall retain the right to use the Licensed Technology within the APD Fields solely as needed to perform its obligations under Section 3 below. For the avoidance of doubt, the forgoing license shall include the right to have third parties manufacture Products on behalf of APD and the right of APD’s customers to use Products delivered to them by or on behalf of APD. Notwithstanding the forgoing, the license granted in this Section 2.1 shall be subject to the terms of License and Development Agreement between Landec and \*\*\*\*\* under which \*\*\* retains a non-exclusive right to use and sell \*\*\*\*\* and which, without APD’s consent, which consent shall not be unreasonably withheld, shall not be amended, renewed, expanded or extended by Landec.

2.2 Technology License to Landec. Subject to the terms and conditions of this Agreement, APD hereby grants to Landec an exclusive, worldwide, non-transferable, non-sublicensable, license for all rights to use, make, have made, market, sell, offer for sale, import and export and otherwise exploit the APD Improvements within the Landec Field; provided, however, that APD shall retain the right to use the APD Improvements within the Landec Field solely as needed to perform its obligations under Section 3 below. For the avoidance of doubt, except as may be explicitly set forth in the Supply Agreement, the forgoing license shall include the right to have third parties (who are not primary polymerization competitors of APD) manufacture products utilizing the APD Improvements on behalf of Landec and the right of Landec’s customers to use products utilizing the APD Improvements delivered to them by or on behalf of Landec in the Landec Field. To the extent that Landec generates any revenue by selling products produced using the APD Improvements in the Landec Field, then Landec shall pay APD a royalty of two percent (2%) of the Net Sales for the Intelimer polymer included in any product which is made using the APD Improvements.

2.3 Ownership. Except for the licenses expressly granted under this Section 2, Landec retains all right, title and interest in and to the Landec IP. Thus, Landec is free to transfer, license and otherwise exploit the Landec IP in the Landec Field worldwide. Except for the licenses expressly granted under this Section 2, APD retains all right, title and interest in and to the APD IP. Thus, APD is free to transfer, license and otherwise exploit the APD IP in the APD Fields worldwide.

2.4 Restrictions. APD will not use the Licensed Technology for a purpose other than to exploit Products for use within the APD Fields as expressly permitted in this Agreement. Landec will not use the APD Improvements for a purpose other than as expressly permitted herein.

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2.5 Improvements Developed with Third Parties. Each Party shall use commercially reasonable efforts to include provisions in third party development contracts that would permit the other Party hereto to receive a license to any Improvements co-developed with a third party and a Party hereto. For those Improvements co-developed by a Party with a third party under a development contract containing the forgoing provisions, the developing Party hereby grants the other Party hereto a license to such Improvement pursuant to Section 2.1 or Section 2.2, as applicable.

2.6 Trademark License and Restrictions.

(a) License Grant. Subject to the provisions of this Agreement, Landec grants to APD a non-exclusive, non-transferable, worldwide, royalty-free license to use the Licensed Trademarks solely in connection with the manufacture, marketing, advertising, sale and offer for sale of the Products in the APD Fields. The foregoing is not an obligation upon APD to use such Licensed Trademarks and APD shall have sole discretion as to whether such Licensed Trademarks are used.

(b) Restrictions. APD agrees that the Products bearing any Licensed Trademarks (which may, as deemed appropriate by APD, be co-branded with APD trademarks) will be manufactured, sold and distributed in accordance with all applicable Laws and regulations and that such products and APD shall use all reasonable efforts to avoid adversely upon the name of Landec or APD. APD shall not challenge or diminish any of Landec's rights in the Licensed Trademarks during the term of this Agreement or thereafter. APD shall not sublicense, explicitly or implicitly any rights in the Licensed Trademarks without the prior express written consent of Landec. APD shall not at any time incorporate any of the Licensed Trademarks or any mark or marks so nearly resembling the same as to be likely to deceive or cause confusion, in its corporate or business name or logo. APD shall not at any time use or apply to register in its name the Licensed Trademarks or any mark or marks confusing similar thereto. Except for APD trademarks associated with co-branding hereunder, all use of the Licensed Trademarks shall accrue to the benefit solely of Landec. APD agrees to provide test samples of Products upon Landec's reasonable request.

(c) Procedure. APD shall provide to Landec for inspection a certificate of analysis, label and product and marketing literature (including all materials using any of the Licensed Trademarks) for the first commercial product in each product family (intended for a specific application) that incorporates a Licensed Trademark or which will be marketed or distributed using a Licensed Trademark a reasonable time prior to the initial sale or distribution of each such product. Landec shall have the right to make reasonable changes, including without limitation changes in the color and font of the mark. At Landec's request, APD will reasonably assist Landec in monitoring the use of the Licensed Trademarks by conducting an annual review with Landec of APD's use of the same. APD will at all times comply with any trademark usage guidelines that may be provided by Landec. In the event of infringement of any of the Licensed Trademarks by any third party, APD will cooperate and assist Landec in the enforcement of Landec's rights therein. Nothing herein shall require APD to use the Licensed Trademarks.

(d) Failure to Comply. In the event that APD fails to comply with the provisions of this Section 2.6, Landec may give written notice specifying the failure to comply. Unless the

failure to comply is remedied within thirty (30) days after such notice, Landec may terminate APD's rights solely under this Section 2.6 immediately upon written notice to APD. Upon such termination, APD shall cease all use of the Licensed Trademarks subject to allowing APD and its customers to exhaust any preexisting compliant inventory and compliant advertising bearing the Licensed Trademarks for up to ninety (90) days thereafter. Termination of this Section 2.6 shall not terminate the license under the Licensed Technology.

### 3. Work Plan and Research Obligations.

3.1 Work Plan. The specific research and development activities to be performed by Landec, together with any assistance to be provided by APD are set forth in the Work Plan. Each of the Parties shall perform its obligations under the Work Plan during the time period in which the Work Plan is in effect which shall be for a period of three (3) Years following the Effective Date and which may be extended by the Parties as provided herein. Prior to the second anniversary of the Effective Date, the Parties shall mutually agree on whether or not to continue the Work Plan for Years four (4) and five (5) of this Agreement and the Parties shall mutually agree on the scope of the R&D that will occur under such Work Plan (e.g., what R&D shall occur, and which party will conduct such R&D). As more fully described in the Work Plan, Landec shall provide to APD agreed upon levels of research and development services, in connection with the Licensed Technology, and technical service and manufacturing support within the APD Fields during the R&D Period. The Work Plan is divided into two parts: the Intelimer Instruction Period and the R & D Period (as defined below).

(a) Intelimer Instruction Period. During the period commencing on the Effective Date and continuing until May 28, 2006 (the "Intelimer Instruction Period"), Landec shall transfer copies of its technology and teach APD about Landec's Intelimer technology by delivering the Intelimer Instruction, as more fully described in the Work Plan, to an extent and a degree reasonably sufficient for APD to replicate the Existing Know-How and manufacture of Landec Intelimer Materials.

(b) R & D Period. The period commencing on the Effective Date and continuing until the expiration or termination of the Work Plan shall be referred to herein as the "R&D Period". During the R & D Period, Landec shall provide mutually agreed upon levels of research and development services, application development, technical service, customer support and manufacturing support in connection with the licensed technology within the APD Fields as further described in the Work Plan. Each of the Parties shall provide to the other Party reasonable technical information and assistance in connection with such other Party's work under the Work Plan. During the R&D Period, on a mutually agreed upon regular basis, each Party shall supply to the other Party reasonable documentation concerning such Party's progress and Improvements under the Work Plan.

(c) A breach of the Work Plan shall not be a breach of this Agreement unless a Party materially fails to satisfy a material obligation under the Work Plan. With respect to the Intelimer Instruction, APD shall notify Landec in writing of such material failure by June 6, 2006 and Landec shall have sixty (60) days to remedy such breach from receipt of notice thereof.

With respect to the R&D Period, APD shall notify Landec in writing of such material breach within thirty (30) days of its knowledge of such breach and Landec shall remedy such breach within sixty (60) days of receipt of notice thereof. The parties agree that APD may request changes to the Work Plan (preferably during the quarterly review meetings as described in Section 3.2) and that Landec will use its reasonable efforts to meet such requests provided; however, that Landec shall retain sole discretion over the use of Landec's resources.

(d) The completion or termination of the Work Plan shall not cause a termination of this Agreement.

3.2 Review Meetings and Customer Visits. At least once per calendar quarter during the R&D Period, at mutually agreeable times and locations, representatives of the parties' research and development teams and business development staff shall meet either in person or by videoconference to discuss the progress under the Work Plan. For in-person customer or toll producer visits or review meetings requested by APD at a non-Landec facility and a non-APD facility (other than a limited number of customer visits agreed to in the Work Plan), APD shall pay all reasonable and previously authorized travel, meal and lodging expenses of Landec personnel to attend each meeting that is conducted in person if APD so requests the attendance of that person, and the Parties shall otherwise bear their own costs associated with the Work Plan, participating in such meetings or customer visits agreed to in the Work Plan.

4. Supply Agreement. Within sixty (60) days of the Effective Date, the parties shall sign an agreement (the "Supply Agreement") for APD to supply Landec with its polymer requirements for \*\*\*\*\*, provided that APD is able to supply such products to Landec, either from third party tollers or APD's in-house production, that meet the volume requirements and quality specifications provided by Landec. APD shall apply a \*\*\* percent (\*\*\*) markup over Total Manufacturing Cost (as defined in the Supply Agreement, the "TMC") to arrive at the final sales price to Landec. The Direct Profits arising from the difference between the sales price to Landec and the TMC will be shared with Landec in the same percentages as for Direct Profits arising from Product sales under Section 6.2 of this Agreement. If APD achieves TMC reductions resulting from any or all of increased production scale, decreased raw material costs, process yield improvements, and overhead cost reductions then the sales price to Landec will be reduced effective in the calendar quarter following the onset of such cost reductions. APD shall be obligated to either: (i) match competitive offers to Landec for such \*\*\* products, provided the quotations are from suppliers capable of sustained production in similar quantities and quality as provided to Landec by APD for such products at that time, or (ii) if APD is unwilling or unable to do so, APD hereby releases Landec from its obligation to purchase its requirement of \*\*\* products from APD. Unless otherwise agreed by the Parties, the Supply Agreement shall not be terminated by any termination of this Agreement and shall not be affected by any exercise of the Buy-Out Option. Any failure to enter into a Supply Agreement or termination of the Supply Agreement shall not terminate this Agreement.

5. Reserved Field Commercialization. There may be up to two (2) Reserved Fields at any time during the Term. Each Reserved Field shall have a period of three (3) Years to be

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Commercialized. If such Reserved Field is Commercialized during such three (3) Year period, it shall convert to an Exclusive Field and the Parties may mutually agree to add a replacement Reserved Field. If a Reserved Field is not Commercialized during such three (3) Year period, then: (i) it automatically reverts back to Landec; (ii) it ceases to be a "Reserved Field" as defined herein; and (iii) the Parties may mutually agree to add a replacement Reserved Field. For every new Reserved Field that is added, such Reserved Field shall have three (3) years to become Commercialized or it will revert to Landec with no further APD rights in such field as provided above.

## 6. Fees; Payment; Taxes.

### 6.1 Scheduled Payments.

(a) Payments upon Agreement Signing. In consideration for the Intelimer Instruction to be given hereunder, APD shall make a non-refundable reimbursement to Landec of one hundred thousand U.S. dollars (\$100,000.00) upon the signing of this Agreement. In partial consideration for the license to the Licensed Technology granted hereunder, APD shall pay net to Landec by wire transfer a non-refundable fee of eight hundred thousand U.S. dollars (\$800,000.00) upon the signing of this Agreement. For the avoidance of doubt, the total non-refundable fee due upon the signing of this Agreement shall be nine hundred thousand U.S. dollars (\$900,000.00).

(b) Quarterly Payments. In partial consideration for the license to the Licensed Technology granted hereunder, prior to the start of each calendar quarter beginning with the first calendar quarter in Year 2 and continuing through the last calendar quarter in Year 3, APD shall pay net to Landec by wire transfer a non-refundable fee of two hundred thousand U.S. dollars (\$200,000.00). For the avoidance of doubt, the total non-refundable quarterly payments payable hereunder shall be one million six hundred thousand U.S. dollars (\$1,600,000.00) and the total non-refundable amounts due under this Section 6.1 shall be two million five hundred thousand U.S. dollars (\$2,500,000.00). Notwithstanding the foregoing, no quarterly payments shall become due or payable hereunder for the post termination period in the event this Agreement is terminated under Section 10.2.

6.2 Profit-Sharing. Commencing on the first anniversary of the Effective Date and continuing through the tenth anniversary of the Effective Date, subject to Sections 10.2 and 11.4 and provided that Landec is not in material breach of this Agreement, APD shall pay net to Landec, forty percent (40%) of Direct Profits from the APD Fields together with forty percent (40%) of Direct Profits from \*\*\* products delivered to Landec under the Supply Agreement. From the tenth anniversary of the Effective Date through the end of the Term, APD shall pay net to Landec, ten percent (10%) of Direct Profits from the APD Fields together with ten percent (10%) of Direct Profits from \*\*\* products delivered to Landec under the Supply Agreement. Notwithstanding the forgoing and subject to Sections 10.2 and 11.4, APD shall make the following minimum payments (the "Minimum Payments") to Landec beginning in Year 2 and continuing through Year 5:

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Year 2: \$500,000  
Year 3: \$1,000,000  
Year 4: \$1,000,000 (Note: Subject to Section 6.4)  
Year 5: \$1,000,000 (Note: Subject to Section 6.4)

In the event that the Direct Profits payable to Landec in any given Year (the "Direct Profit Payment") is less than the Minimum Payment due for that Year, APD shall pay Landec the difference between the Direct Profit Payment and such Minimum Payment prior to the end of such Year. In the event that APD fails to make payments under this Section 6.2 meeting the Minimum Payment due in any given Year, Landec may convert the license in the Exclusive Fields to a non-exclusive license and revoke the license in the Reserved Fields. For the avoidance of doubt, there are no Minimum Payment obligations from Year 6 through the end of the Term. A failure to make Minimum Payments because the actual sales of Products were not high enough to trigger the Minimum Payments shall not entitle Landec to terminate this Agreement but shall entitle Landec to the remedies contained in this paragraph.

6.3 Continued Technical Support. During the initial three (3) Years, Landec will provide resources to reasonably facilitate the objectives described at Exhibit G, as modified by the Parties in the Work Plan from time to time to reflect commercial or technical circumstances and objectives. Such commitment from Landec will be negotiated in good faith by the Parties and will be included in future versions of the Work Plan. The foregoing commitment may continue, in whole or in part, during Years 4 and 5, in accordance with the Work Plan and as mutually decided by the Parties pursuant to Section 6.4. For the avoidance of doubt, there are no ongoing support obligations from Year 6 through the end of the Term.

6.4 Changes to Minimum Payments. Notwithstanding the provisions of Sections 6.2 and 6.3, within thirty (30) days following the mutual determination of the Parties of the existence and scope of R&D efforts in Years 4 and 5 pursuant to Section 3.1, APD and Landec shall negotiate in good faith reducing Minimum Payments to be commensurate with any reduction in Landec resources provided under Section 6.3 for Years 4 and 5; provided, however, that APD shall remain obligated to pay Landec, forty percent (40%) of Direct Profits as provided in Section 6.2.

6.5 Buy-Out Option. At any time commencing at the start of Year 11, or commencing at the start of any succeeding Year, APD may pay Landec \*\*\* percent (\*\*\*) of the Direct Profits arising from the sale or license of Products from the immediate prior Year, excluding any non-recurring charge that occurred in such Year and APD shall have no further obligations to make Direct Profit Payments under Section 6.2. This balloon payment shall be in lieu of the 10% Direct Profit Payments that would otherwise be due pursuant to Section 6.2 for the remainder of the Term and is referred to herein as the "Buy-Out Option".

6.6 Sales, General and Administrative Costs. APD shall pay all of its costs related to sales, administration and other general costs related to development, sale and distribution of the Products. Such costs shall include, without limitation, process engineering support and costs of technical services related to sales and marketing. APD shall dedicate adequate working capital to permit it to Commercialize the Products in the Reserved Fields and meet all of its obligations hereunder related to the APD Fields. All of the foregoing costs and working capital paid by APD shall be in amounts deemed solely by APD to be adequate. It is contemplated by the

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Parties that all of the forgoing will be provided by APD after completing the Work Plan; however, in the event that APD reasonably requests that Landec provide any of the forgoing, APD shall reimburse Landec for the previously authorized costs thereof. For the avoidance of doubt, except to the extent that the Work Plan explicitly says that Landec is paying for any of the costs described in this Section 6.6, after the Intelimer Instruction period, any and all of the costs described in this Section 6.6 requested by APD and performed by Landec or contained in the Work Plan shall be paid for by APD.

6.7 Payment and Taxes. Payments due under Section 6.2 shall be paid monthly within thirty (30) days of such time as APD receives payments from its customers for Products or from Landec under the Supply Agreement. All payments shall be made in United States dollars in immediately available funds. APD shall pay all applicable sales, use, excise and similar taxes and duties in connection with the Products and in connection with all payments made under this Section 6, as well as any applicable bank and/or clearing charges, unless such charges are paid by the customer. Amounts payable under this Section 6 or any other part of this Agreement that are not paid when due shall bear interest at the rate of Prime plus one and one-half percent (1.5%), where "Prime" means the prime U.S. inter-bank lending rate on the first business day of the calendar quarter in which such interest accrues, as reported in the Wall Street Journal.

6.8 Audit. Landec shall have the right to appoint an independent third party auditor, not unreasonably objectionable to APD and bound by confidentiality obligations, to audit APD's books and records related solely to this Agreement, sales of Products and \*\*\* products and the calculation of Direct Profits hereunder. The costs of such audit shall be paid for by Landec provided, however, that (i) APD shall immediately pay the amount of the underpayment revealed by the audit (if any); and (ii) in the event that such audit reveals an underpayment of five percent (5%) or more, APD shall pay all costs associated with conducting such audit. The audits permitted hereunder will not be performed more often than annually. Any Direct Profit Payments not disputed within three (3) years of their quarter shall be deemed acceptable and accurate.

6.9 To the extent that a Landec patent in the \*\*\* Field is invalidated and, as a result, a particular Product exploited by APD hereunder is not covered by any Landec patent, then the Parties shall meet and reasonably discuss a Direct Profit Payment reduction with respect to such Product; provided, however, that if such Product (or the manufacture thereof) involves the use or exploitation of Landec Intelimer Materials, Existing Know-How, Improvements or Proprietary Information (provided that the foregoing have not entered the public domain) then no reduction in the Direct Profit Payments payable hereunder shall occur.

## 7. Representations and Warranties.

7.1 Each Party hereby represents and warrants to the other Party that it has been duly incorporated and is validly existing in good standing as a corporation under the laws of its jurisdiction of incorporation, with the requisite corporate power and authority to enter into this Agreement.

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7.2 Landec hereby represents and warrants to APD that, to the best of Landec's knowledge the Patent Properties and exploitation of Landec Intelimer Materials in the APD Fields may be exploited in such a manner as to not infringe any third party patents.

7.3 Landec hereby represents and warrants that it solely owns all right, title and interest in the Licensed Technology or otherwise has the right to grant the licenses granted hereunder, and that Exhibits A, C, F and, to the best of Landec's knowledge, E are complete and accurate as of the Effective Date.

7.4 Landec hereby represents and warrants that the Patent Properties are valid and enforceable, and that a portion of the Licensed Technology in the APD Field (excluding disposable nonwovens and electronics) is covered by the Patent Properties.

7.5 Landec hereby represents and warrants that to the best of its knowledge: (i) the Existing Know-How and Patent Properties can be manufactured in accordance with the Intelimer Instruction and used for the APD Fields, and (ii) the manufacture, shipment, disposal and use of the Existing Know-How and Patent Properties in the APD Fields does not violate any federal, state or governmental regulations or standards (including, without limitation, OSHA, EPA, among other US and non-US regulatory agencies, in each case, to the extent they have jurisdiction) when manufactured and used in accordance with Landec's published specifications and recommended use (as contained in product data sheets, formulation sheets and product bulletins), provided that an immaterial failure to follow such recommended uses shall not relieve Landec of its responsibilities hereunder.

7.6 Landec hereby represents and warrants that it will disclose all of Landec's Existing Know-How, Landec Improvements and Proprietary Information, in sufficient detail to allow APD to manufacture, use and sell the Product in the APD Fields.

7.7 Landec hereby represents and warrants that, as of the Effective Date, the Landec Intelimer Materials do not infringe on those patents and patent applications in the \*\*\* Field listed on Exhibit E. If APD suffers damages arising out of a breach of this representation and warranty its only remedies shall be termination under Section 10.2, indemnification under Section 11.1 and the Impairment provisions of Section 11.4 and APD may set off the amounts for which it would be entitled to an indemnity against Direct Profit Payments that would otherwise be due to Landec hereunder.

## 8. Confidentiality.

8.1 Confidential Information. Each Party shall treat as confidential all Proprietary Information of the other Party, shall not use such Proprietary Information except as set forth in this Agreement, and shall use its best efforts not to disclose such Proprietary Information to any third party except to its professional advisors under a duty of non-disclosure. Without limiting the foregoing, each of the Parties shall use at least the same degree of care which it uses to prevent the disclosure of its own Proprietary Information of like importance to prevent the disclosure of Proprietary Information disclosed to it by the other Party under this Agreement. Each Party shall disclose Proprietary Information of the other Party only to its directors, officers,

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employees, consultants and advisors who have a need to know such information in order for such Party to carry out the activities and transactions contemplated by this Agreement. Each Party shall promptly notify the other Party of any actual or suspected misuse or unauthorized disclosure of the other Party's Proprietary Information.

8.2 Exceptions. Notwithstanding the above, neither Party shall have liability to the other with regard to any Proprietary Information of the other which the receiving Party can prove:

- (i) was in the public domain at the time it was disclosed or has entered the public domain through no fault of the receiving Party;
- (ii) was known to the receiving Party, without restriction, at the time of disclosure;
- (iii) is disclosed with the prior written approval of the disclosing Party;
- (iv) was independently developed by employees or consultants of the receiving party that have not received access to the Proprietary Information of the disclosing party; or
- (v) is disclosed pursuant to the order or requirement of a court, administrative agency, or other governmental body; provided, however, that the receiving Party shall provide prompt notice of such court order or requirement to the disclosing Party to enable the disclosing Party to seek a protective order or otherwise prevent or restrict such disclosure.

8.3 Regulatory Filings. Landec agrees that the version of this Agreement that it files with the U.S. Securities and Exchange Commission shall include a request to seek confidential treatment in a manner mutually agreed upon by the Parties. Except as required to be submitted to the U.S. Securities and Exchange Commission or as contained in a mutually acceptable announcement or press release, the terms of this Agreement shall be maintained confidential.

## 9. Intellectual Property; Patent Matters.

### 9.1 Licensed Technology and Improvements.

9.1.1 Subject to the terms and conditions of this Agreement, any APD Improvements and Joint Use Improvements with at least one claim applicable to or covering at least one of the APD Fields shall be solely owned by APD and any Landec Improvements and other Joint Use Improvements with at least one claim applicable to or covering at least one of the Landec Fields shall solely be owned by Landec. Subject to Section 9.1.5 below, Landec hereby assigns to APD all right, title and interest in and to any APD Improvements and Joint Use Improvements in the APD Fields that Landec has or may hereafter acquire. Subject to Section 9.1.5 below, APD hereby assigns to Landec all right, title and interest in and to any Landec Improvements and other Joint Use Improvements in the Landec Field that APD has or may hereafter acquire. The Parties agree that a patent application may include either or all of a Joint Use Improvement, a composition of matter Improvement and/or a process Improvement. The Parties will and hereby do assign ownership of patents and other intellectual property covering such Improvements in

accordance with the terms and conditions of this Agreement and such Improvements may be pursued as separate patents.

9.1.2 Subject to Section 9.1.3, Landec shall, with the full co-operation of APD, and in Landec's sole discretion, be responsible for preparing, filing, prosecuting, maintaining and renewing any patent applications and patents covering the Landec IP worldwide and shall do so at its sole cost and expense. Subject to Section 9.1.3, APD shall, with the full co-operation of Landec, and in APD's sole discretion, be responsible for preparing, filing, prosecuting, maintaining and renewing any patent applications and patents covering the APD IP worldwide and shall do so at its sole cost and expense. The prosecuting Party shall promptly provide copies of all U.S. and foreign patent office correspondences to the other Party, and the prosecuting Party shall have the sole discretion as to prosecution strategy for Improvements, including appeals, abandonment, claim coverage, maintenance fee payment and annuity fee payment, without liability to the other Party.

9.1.3 If a Party (the "Requesting Party") wants to broaden the other Parties' patent coverage with respect to the APD Fields (where APD is the Requesting Party) or the Landec Field (where Landec is the Requesting Party), the Parties will reasonably discuss such action and the Requesting Party will bear all costs for preparing, filing, prosecuting, maintaining and renewing any patent applications and patents related to such request.

9.1.4 In the event that either party wishes to abandon any Improvements it owns hereunder within any part of the applicable territory that party shall notify the other party in writing and, if mutually agreed between the parties, shall transfer ownership and prosecution responsibility for such Improvements in the applicable territory to the other party. Such abandonment shall not include normal claim amendments, cancellations or other limitations made to patent claims during routine prosecution.

9.1.5 The parties shall make their reasonable endeavors to divide all Improvements so it can be solely owned by one or other Party according to their respective fields in accordance with Section 9.1.1 above. However, notwithstanding Section 9.1.1 above, if by mutual written agreement the Parties agree that some Improvement should be owned jointly, the Parties shall grant each other exclusive cost-free licenses in their respective fields worldwide under that jointly owned Improvement. Notwithstanding Section 9.1.2, the procedures for filing, prosecuting, maintaining and renewing any such jointly owned applications for protection of Improvement worldwide shall be agreed between the Parties in writing on a case by case basis. Except as otherwise agreed by the Parties, to the extent that any Improvement is useful in the Landec Field and the APD Fields: (a) Landec hereby grants to APD a perpetual, worldwide, non-sublicensable, non-transferable license to exploit within the APD Fields such Improvement as may be owned by Landec, and APD shall pay Landec a license fee equal to two percent (2%) of the Net Sales resulting from the sale of Intelimer polymers containing such Improvements and (b) APD hereby grants to Landec a perpetual, worldwide, non-sublicensable, non-transferable license to exploit within the Landec Fields such APD Improvement or Joint Use Improvement as may be owned by APD and Landec agrees to pay APD two percent (2%) of the Net Sales resulting from the sale of Intelimer polymers containing such Improvements. Notwithstanding anything herein to the contrary, in the event that APD develops an APD Improvement or a Joint use Improvement in a Reserved Field that APD fails to Commercialize, then APD hereby grants

to Landec an exclusive, perpetual, worldwide, sublicensable and transferable license to sell and otherwise exploit within the Reserved Field such Improvement as may be owned by APD and Landec agrees to pay APD two percent (2%) of the Net Sales resulting from the sale of Intelimer polymers containing such Improvements and Landec further agrees that any third party manufacturer of such Improvement will not be a primary polymerization competitors of APD. Notwithstanding anything herein to the contrary, without APD's prior written approval, Landec shall not have the right to transfer or sublicense any APD Improvement to a direct polymerization competitor of APD. For the avoidance of doubt, during the Term of the Agreement, any amounts payable by APD under this Section 9.1.5 shall be included within and not be in addition to the Direct Profit Payments.

9.1.6 Each Party agrees to cooperate with the other Party or its designee(s) (at such other Party's expense if not otherwise expressly set forth herein), both during and after the term of this Agreement, in applying for, obtaining, perfecting, evidencing, sustaining and enforcing their respective or jointly owned rights in Improvements, including, without limitation, executing such written instruments (including, without limitation, declarations, assignments and powers of attorney) as may be prepared by such Party, using protocols appropriate to research and development activities to ensure all inventors sign appropriate documents, coordinating and agreeing on timing of filing patent applications and scope of claims for related inventions in the respective Fields and doing such other acts as may be necessary in the opinion of such Party to obtain a patent, register a copyright, or otherwise enforce such Party's rights in such Improvement and such products, respectively.

9.1.7 The parties hereto agree that Improvements generated within this Agreement are part of a joint research agreement and effort, pursuant to 35 U.S.C. §103(c), and that each party will promptly execute any document, including a terminal disclaimer, and other documents deemed necessary by the U.S. Patent and Trademark Office ("USPTO") to comply with this statutory provision. This section 9.1.7 is excluded from any confidentiality restrictions provided for in this Agreement and can be filed with the USPTO.

## 9.2 Enforcement of Rights

9.2.1 Notice of Alleged Infringement. Each Party shall provide written notice (an "Infringement Notice") promptly to the other Party of any alleged infringement by a third party of the Licensed Technology or Improvement in the APD Field, which becomes known to the first Party and, together with such notice, provide the other Party with all evidence in the notifying Party's possession of such alleged infringement.

9.2.2 Enforcement. Following an Infringement Notice from either Party, the party that owns the relevant Proprietary Rights shall have the first right, but not the obligation, to enforce, at its own expense and utilizing counsel of its own choice, any actual or alleged infringement or misappropriation of the Proprietary Rights. In the event that the owning Party does not elect to initiate a suit or action as provided above within six (6) months of the applicable Infringement Notice, the other Party shall have the right, but not the obligation, to prosecute or defend against, at its expense and utilizing counsel of its choice, any actual or alleged infringement or misappropriation of the Proprietary Rights.

9.2.3 Party to the Suit. In the event one Party gives notice to the other Party that in the first Party's opinion they should both take action against a third party with respect to infringement of any jointly owned Improvement, and in the event that the Parties cannot promptly agree to a joint enforcement course of action, or if a Party indicates its intent not to act ("the Non-Enforcing Party"), the Party which desires to take action through licensing, litigation or arbitration, may take such action ("the Patent Enforcing Party"). In that event, the Patent Enforcing Party shall solely be responsible for all enforcement strategy, and attorneys' fees and costs associated with the enforcement, and shall solely receive all damages, awards, proceeds and compensation from the infringer, whether from licensing, litigation or arbitration, and even if the Non-Enforcing Party joined pursuant to Fed. R.Civ. P. 19 or the like but is not an actively paying participant in the enforcement action. The Non-Enforcing Party shall voluntarily join if deemed necessary by a court or arbitrator pursuant to Fed. R. Civ. P. 19 or the like, but only if the accused infringer is not a current customer, current joint venturer, or current supplier to the joining Non-Enforcing Party. The Patent Enforcing Party shall promptly reimburse the Non-Enforcing Party for all reasonable attorneys' fees and costs associated with the litigation or arbitration initiated by the Patent Enforcing Party.

9.2.4 Damages. Any award of damages or any other amounts awarded, recovered or obtained in connection with a disposition of any suit or legal action under this section shall be for the benefit of the Party bringing or entering the suit or legal action, but only to the extent arising from infringements or misappropriation within the APD Fields; all other proceeds shall be the property of and shall be retained by or provided to Landec. In the event that Landec refuses to bring suit for an infringement within the APD Fields and APD successfully concludes such an action where a third party was found to infringe in the APD Field, then the amount of Direct Profits payable hereunder shall be reduced by a mutually agreed amount that represents the royalty that would have been due from such infringer in relation to the sales that were made by such infringer over the period of two (2) years prior to the date of final resolution of such action. APD shall be permitted to settle such an action provided, however, it must obtain Landec's prior written consent, which will not be unreasonably withheld, prior to agreeing to any such settlement in which there is a reasonable likelihood that Landec would be adversely affected by any such settlement.

9.2.5 Options Upon Notice of Infringement. Landec and APD agree to work cooperatively regarding issues concerning Proprietary Rights and similar matters and to exercise reasonable business judgment in carrying out the objectives of this Agreement to avoid exposing either Party to liability under patent or similar Laws in any of the countries in the applicable territory.

## 10. Term and Termination.

10.1 Term. The term of this Agreement shall commence upon the Effective Date and continue thereafter until the later of (i) the last to expire of any of the Patent Properties or (ii) twenty (20) years from the Effective Date (the "Term") unless terminated earlier, as provided herein.



## 10.2 Early Termination.

(a) Upon any material breach of, or material default under, this Agreement (including failure to make any payment due hereunder or abandonment of a substantial portion of the Licensed Technology by APD) by a Party, if the non-breaching Party notifies the breaching Party within ninety (90) days of gaining knowledge of such breach, the non-breaching Party may terminate this Agreement upon written notice to the breaching Party unless the breaching Party cures such breach or default within sixty (60) days (or with respect to late payments under Section 6, within thirty (30) days) after the date of such written notice. If APD exercises the Buy-Out Option in accordance with Section 6.5, then this Agreement shall terminate as of the date of such exercise. In the event that the aggregate revenues of APD in the \*\*\* Field are \*\*\*\*\* below those Revenue Projections listed in Exhibit D in any one of the \*\*\* and such shortfall is caused by \*\*\*\*\*, then, at either Party's request, the Parties shall engage in good faith discussions regarding terminating this Agreement and transferring customer relationships and the licenses granted hereunder back to Landec.

(b) At anytime during the \*\*\*, APD may terminate this Agreement upon ninety (90) days prior written notice if there is a \*\*\*\*\*, or based upon opinion from counsel which has been made known to Landec (in a manner to preserve attorney client privilege), \*\*\*\*\*.

10.3 Effect of Expiration or Termination. The termination or expiration of this Agreement shall not: (a) relieve a Party hereto of any obligation accruing to such Party prior to such termination; or (b) result in the waiver of any right by a Party hereto accruing to such Party prior to such termination.

10.4 Survival. The following sections of this Agreement shall survive expiration or termination of this Agreement for any reason: Sections 1, 2.1 (only to the extent necessary to permit APD to exploit the APD Improvements or Joint Use Improvements created prior to such termination on a non-exclusive basis and APD shall pay Landec a license fee of two (2%) percent of the Net Sales of Intelimer polymers), 2.2 (only to the extent necessary to permit Landec to exploit the APD Improvements or Joint Use Improvements created prior to such termination on a non-exclusive basis and Landec shall pay APD a license fee of two percent (2%) of Net Sales of Intelimer polymers to the extent that they use the APD Improvements or Joint Use Improvements), 2.3, 2.4, 4 (pursuant to the terms of the Supply Agreement), 6.8, 8, 9, 10, and 12 through 15. Notwithstanding the forgoing, (i) to the extent that Landec terminates this Agreement for APD's material breach, Section 2.1 (only to the extent necessary to permit APD to exploit the APD Improvements or Joint Use Improvements created prior to such termination on a non-exclusive basis) shall survive and APD shall pay Landec a license fee of five percent (5%) of Net Sales of Intelimer polymers; and (ii) to the extent that APD terminates this Agreement for Landec's material breach, Section 2.2 shall survive on a non-exclusive basis (only to the extent necessary to exploit APD Improvements or Joint Use Improvements created prior to such termination) and Landec shall pay APD a license fee of five percent (5%) of Net Sales of Intelimer polymers to the extent that they use the APD Improvements. Notwithstanding the forgoing, Section 2.1 shall not survive in the event of any termination under Section 10.2 (b), except for APD's continued right to exploit the APD Improvements or Joint Use Improvements

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created prior to such termination provided that APD shall pay Landec a license fee of five percent (5%) of Net Sales of Intelimer polymers.

10.5 Not Sole Remedy. The foregoing termination rights are in addition to, and not in lieu of, any other remedy available under this Agreement unless otherwise expressly provided herein.

#### 11. Indemnification.

11.1 By Landec. Subject to Section 11.3 below, during the first three (3) Years of the Term of this Agreement, Landec shall indemnify, defend and hold APD and its directors, employees, agents and affiliates harmless from and against all damages, losses, liabilities, costs (including without limitation reasonable attorneys' fees) and expenses (including any pre-approved settlement) in connection with (i) any third party claim to the extent arising out of the actual or alleged infringement or violation of any third party right by exploitation of the Licensed Technology in the manner contemplated by this Agreement; or (ii) any breach of the representations and warranties hereunder. Notwithstanding the preceding sentence, Landec's obligations under this Section 11 will not apply to any claims, damages, liabilities, costs or expenses to the extent that they arise out of: (x) specifications provided by APD that are prepared without collaboration with Landec; (y) modifications of any Licensed Technology in the APD Fields, which are not covered by Landec Improvements or Joint Use Improvements, or that materially alter the form or functionality thereof or (z) combinations of any of the Licensed Technology in the APD Fields with any product not provided by Landec; provided that such combination materially alters the form or function of the Licensed Technology or that such claim, damage, liability, cost or expense arises out of or relates to such non-Landec product ((x), (y) and (z), collectively, "Held Back Claims"). Following the three (3) year indemnity period, APD shall have no claim and Landec shall have no obligations with respect to (i) and (ii) above for claims made after the first three (3) Years of the Term of this Agreement. Notwithstanding anything to the contrary, Landec shall not be obligated to indemnify APD pursuant to this Section 11.1 unless and until the total amount of losses incurred by APD exceeds fifty-thousand dollars (\$50,000.00 USD) in the aggregate, in which event Landec shall indemnify APD for all losses as otherwise provided herein.

11.2 By APD. Subject to Section 11.3 below, during the Term of this Agreement and thereafter, APD shall indemnify, defend and hold Landec and its directors, employees, agents and affiliates harmless from and against all damages, losses, liabilities, costs (including without limitation reasonable attorneys' fees) and expenses (including any pre-approved settlement) in connection with: (i) any Held Back Claim; or (ii) any third party claim to the extent arising out of any Product manufactured and/or sold by APD, except to the extent that APD is entitled to indemnification from Landec under Section 11.1 above. APD's indemnification obligation under this Section 11.2 shall be capped at a total amount of two and one-half million dollars.

11.3 Conditions to Indemnification. In any claim for defense or indemnification hereunder, the indemnified party must (i) give the indemnifying party prompt written notice of the applicable claim; (ii) reasonably cooperate with the indemnifying party at the indemnifying

party's request and expense, in the defense and/or settlement of the claim; and (iii) give the indemnifying party the right to control the defense and/or settlement of the claim, except that the indemnifying party will not enter into any settlement that adversely affects the indemnified party's rights or obligations without the indemnified party's proper express written consent, which will not be unreasonably withheld or delayed. The indemnified party may participate in the defense and/or settlement of any such claim at its own expense with counsel of its choosing. Notwithstanding the foregoing, any failure of the indemnified party to comply with the provisions of this Section 11.3 will not relieve the indemnifying party of any defense or indemnity obligations hereunder except to the extent that the indemnifying party is prejudiced by such failure.

#### 11.4 Impairment.

(a) For the first three (3) Years, in the event that the Revenue Projection (as defined below) in any such Year listed in Exhibit D (\*\* Field Customer Sales Forecast) are not met due to: (i) \*\*, as reasonably documented, confirming that the primary reason for \*\* not meeting \*\* the Revenue Projection at Exhibit D is that \*\*\*\*\*, and/or (ii) if \*\*\*\*\* terminate or reduce the sale of Products \*\*\*(i) and (ii) are referred to herein as "Impairment"); then APD's Direct Profit Payments payable under Section 6.2 to Landec shall be reduced as described in this Section 11.4. In any or all of the first 3 Years, if an Impairment occurs during such Year, then APD's Direct Profit Payments to Landec shall be reduced by the Impairment Amount (as defined below) in the immediate following Year as described below.

(b) A "Revenue Projection" for a particular Year shall mean the revenues in the Personal Care Field projected for that Year, as described on Exhibit D.

(c) A "Direct Profit Projection" for a particular Year shall mean the Direct Profits in the Personal Care Field projected for that Year, as described on Exhibit D.

(d) The "Impairment Amount" shall be calculated by obtaining the percentage by which the revenues in the \*\* Field in any of the first three (3) Years falls below the Revenue Projection due to an Impairment for that Year and then multiplying that percentage by the Direct Profit Projection for that Year to obtain a dollar amount which shall be the Impairment Amount. Notwithstanding the forgoing, for the purpose of calculating the Impairment Amount, the total revenues for a Year shall include revenues from all customers of APD in the \*\* Field, whether or not listed in Exhibit D and, for the avoidance of doubt, shall also include the revenues from the patent owner(s) listed on Exhibit E and shall include all revenues from those customers on Exhibit D that purchase more Products than was projected for such customer.

(e) The Direct Profit Payments to Landec which are reduced in accordance with this Section 11.4 shall be reduced in the Year immediately following the Year during which an Impairment has occurred by reducing each monthly Direct Profit Payment by one twelfth of the Impairment Amount. By way of example, if revenues in Year 2 were thirty percent (30%) below the Revenue Projection ((Revenue Projection-Actual Revenues from Customers in Exhibit D)/Revenue Projection) in the \*\* Field, and this reduction was caused by Impairment, then this percentage multiplied by the Direct Profit Projection for Year 2 would determine the Impairment

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Amount for Year 2 to be subtracted in equal monthly installments from the Direct Profit Payments in Year 3. If the Direct Profit Projection was \$200,000 in Year 2, the Impairment Amount would be \$60,000 and the monthly Direct Profit payments in Year 3 would be reduced by \$5,000 per month. As a further example, if this same thirty percent (30%) Impairment was offset by a five percent (5%) (as a percent of the Revenue Projection) increase in revenues from a customer in the \*\*\* Field in Exhibit D and an additional ten percent (10%) of revenues from a customer in the \*\*\* Field not listed in Exhibit D then, in accordance with Section 11.4 (d), fifteen percent (15%) would be multiplied by the Direct Profit Projection to determine the Impairment Amount. If the Direct Profit Projection was \$200,000 in Year 2, the Impairment Amount would be \$30,000 and the monthly Direct Profit payments in Year 3 would be reduced by \$2,500 per month.

(f) APD agrees to provide Landec with information on the appropriate customer contacts and access to those customers listed on Exhibit D in order to verify the terms of this Section 11.4. Any amounts withheld from Landec in accordance with this Section 11.4 shall count towards Landec's total aggregate liability under Section 12.2. The Minimum Payments described at Section 6.2 shall be reduced in the Year immediately following the Year during which the Impairment has occurred by the same dollar amount as the Direct Profit Payments are reduced by an Impairment under this Section 11.4. The Parties may agree to pay certain amounts \*\*\*, to the \*\*\* which will count towards the Impairment Amount.

11.5 Sole Remedy. The indemnification obligations under this Section 11 shall be the indemnifying party's sole obligation and the indemnified party's sole remedy with respect to any breach of Section 7 or other event giving rise to indemnification hereunder.

## 12. Limitation of Liability and Disclaimers.

12.1 INCIDENTAL AND CONSEQUENTIAL DAMAGES. NEITHER PARTY WILL BE LIABLE UNDER ANY CONTRACT, NEGLIGENCE, STRICT LIABILITY OR OTHER LEGAL OR EQUITABLE THEORY FOR ANY INCIDENTAL OR CONSEQUENTIAL DAMAGES WITH RESPECT TO ANY SUBJECT MATTER OF THIS AGREEMENT, EXCEPT IN CONNECTION WITH A BREACH OF SECTION 8 ABOVE OR AS EXPRESSLY DESCRIBED IN SECTION 11.4 OR FOR LIABILITY ARISING OUT OF A PARTY EXCEEDING THE SCOPE OF ANY LICENSE GRANTED TO SUCH PARTY HEREUNDER.

12.2 LIMITATION OF OBLIGATIONS AND LIABILITY. IN NO EVENT WILL LANDEC BE LIABLE UNDER THIS AGREEMENT WITH RESPECT TO ANY SUBJECT MATTER OF THIS AGREEMENT UNDER ANY CONTRACT, NEGLIGENCE, STRICT LIABILITY OR OTHER THEORY FOR COST OF PROCUREMENT OF SUBSTITUTE GOODS, SERVICES, TECHNOLOGY OR RIGHTS OR FOR ANY AMOUNTS AGGREGATING IN EXCESS OF THE CUMULATIVE AMOUNTS ACTUALLY PAID BY APD TO LANDEC PURSUANT TO SECTION 6.1 OF THIS AGREEMENT OR TWO AND ONE HALF MILLION DOLLARS; WHICHEVER IS LESS. FURTHERMORE, THE AMOUNT OF ANY REDUCTION IN DIRECT PROFIT PAYMENTS THAT WOULD HAVE

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BEEN PAID TO LANDEC PURSUANT TO SECTION 11.4 HEREOF SHALL FURTHER REDUCE LANDEC'S TOTAL MAXIMUM LIABILITY HEREUNDER.

12.3 DISCLAIMERS. TO THE EXTENT THAT LANDEC HAS PUBLISHED SPECIFICATIONS OR OTHERWISE PROMOTED USAGE OF THE INTELIMER TECHNOLOGY FOR A CERTAIN APPLICATION, THEN LANDEC HEREBY WARRANTS THAT SUCH TECHNOLOGY MAY BE USED FOR SUCH APPLICATION, PROVIDED THAT IT IS USED IN COMPLIANCE WITH SUCH PUBLISHED SPECIFICATIONS AND RECOMMENDED USES. OTHER THAN THE FORGOING REPRESENTATION AND THOSE REPRESENTATIONS AND WARRANTIES CONTAINED AT SECTION 7, THE LANDEC INTELIMER MATERIALS AND THE LICENSED TECHNOLOGY ARE PROVIDED "AS IS" AND WITHOUT WARRANTY OF ANY KIND, EXPRESS OR IMPLIED, INCLUDING WITHOUT LIMITATION WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE OR NON-INFRINGEMENT.

13. Independent Contractors. The Parties are independent contractors and not partners, parties to a joint venture or otherwise affiliated, and neither has any right or authority to bind the other in any way.

14. Assignment. The rights and obligations of the Parties under this Agreement may not be assigned or transferred (and any attempt to do so will be void) except (a) to an Affiliate, and (b) this Agreement and the rights and obligations hereunder may be assigned to an acquirer of all or substantially all of the assets of the assigning Party to which this Agreement relates, or to an acquirer of a majority of the voting power of the then outstanding capital securities of the assigning Party. In the event that Section 14 (b) above shall apply to an Affiliate of a Party hereto, then such Affiliate shall continue to be bound by the rights and obligations of this Agreement. Any purported assignment in violation of this section is void. Subject to the foregoing, this Agreement is binding upon and shall inure to the benefit of the Parties and their respective successors and assigns.

15. Miscellaneous.

15.1 Amendment and Waiver. Except as otherwise expressly provided herein, any provision of this Agreement may be amended and the observance of any provision of this Agreement may be waived (either generally or any particular instance and either retroactively or prospectively) only with the written consent of the parties.

15.2 Governing Law; Jurisdictions. This Agreement shall be governed by and construed in accordance with the Laws of the State of New York applicable to contracts made and to be performed wholly therein between parties residing in New York, without regard to conflicts of laws provisions thereof and without regard to the United Nations Convention on

Contracts for the International Sale of Goods. All disputes arising out of or in connection with this Agreement shall be finally settled by binding arbitration under the rules of the American Arbitration Association (“AAA”) in accordance with said rules. The location of such arbitration shall be in New York, New York. The arbitration shall be conducted by a panel of three arbitrators who are knowledgeable in the subject matter which is at issue in the dispute and at least two of which shall be a registered U.S. Patent Attorneys or patent agents (the “Panel”). Each Party shall have the right to appoint one member of the Panel, with the third member to be mutually agreed by the two Panel members appointed by the Parties, or, failing such agreement, shall be selected according to the AAA rules. In conducting the arbitration, the Panel shall determine what discovery will be permitted, consistent with the goal of limiting the cost and time which the Parties must expend for discovery (and provided that the Panel shall permit such discovery deemed necessary to permit an equitable resolution of the dispute). The decision of the Panel shall be in writing and shall set forth the basis therefore. The Parties shall abide by all awards rendered in arbitration proceedings, and such awards may be enforced and executed upon in any court having jurisdiction over the Party against whom enforcement of such award is sought. The Panel shall also determine the steps, if any, that a Party should take to correct any failure or breach by such Party pertaining to any such dispute. The Parties shall share equally the Panel’s fees and expenses unless otherwise determined by the Panel. Notwithstanding the foregoing, either party may seek injunctive relief, to the extent permitted herein, in any court of competent jurisdiction.

15.3 Headings. Headings and captions are for convenience only and are not to be used in the interpretation of this Agreement.

15.4 Notices. All notices, requests, approvals, consents or other communications required or permitted to be given herein shall be in writing and shall be sufficiently given if delivered personally, forwarded by certified mail with proper postage prepaid and return receipt requested (or by other prepaid commercial delivery service that documents delivery) or transmitted by email with an email acknowledgement confirming delivery by the recipient, in each case to the Party to which directed at its address indicated below. Such communications shall be deemed given upon delivery on a business day to the address stated herein of the Party to which directed (notwithstanding any acceptance, rejection or acknowledgment of such delivery) or, if not delivered on a business day, the next succeeding business day. Any Party may from time to time designate in writing any other address to which such communications shall be sent.

If to APD, to:

Air Products And Chemicals, Inc.  
7201 Hamilton Boulevard  
Allentown, Pennsylvania 18195  
Atten: Business Manager Personal Care Products

With a copy to: Office of Chief Patent Counsel

If to Landec, to:

Landec Corporation  
3603 Haven Avenue  
Menlo Park, California 94025-1010  
Telephone Number: Main — (650) 306-1650; Direct — (650) 261-3686  
Email: sbitler@landec.com

With a copy to: dtaft@landec.com  
Attention: Steven P. Bitler, Vice President, Corporate Technology

with a copy to: APD Relationship Manager

15.5 Entire Agreement. This Agreement, together with all attachments and exhibits hereto, supersedes all prior proposals, oral or written, all negotiations, conversations, or discussions between or among the parties relating to the subject matter of this Agreement. The foregoing language shall not be read to supersede the Supply Agreement to be negotiated by the Parties pursuant to Section 4 provided, however, this Agreement shall govern any conflicts between the Supply Agreement and this Agreement, unless the parties explicitly state otherwise in the Supply Agreement.

15.6 Force Majeure. Neither Party hereto shall be responsible for any failure to perform its obligations under this Agreement (other than obligations to pay money) if such failure is caused by acts of God, war, terrorism (actual or threatened), strikes, revolutions, lack or failure of transportation facilities, Laws or other causes that are beyond the reasonable control of such Party. Obligations hereunder, however, shall in no event be excused but shall be suspended only until the cessation of any cause of such failure. In the event that such force majeure should obstruct performance of this Agreement for more than six (6) months, the Parties hereto shall consult with each other to determine whether this Agreement should be modified. The Party facing an event of force majeure shall use its reasonable efforts in order to remedy that situation as well as to minimize its effects. A case of force majeure shall be notified to the other Party by email within five (5) days after its occurrence and shall be confirmed by a letter. In no event shall this Section 15.6 serve to extend the term of this Agreement.

15.7 Severability. If any provision of this Agreement is held illegal, invalid or unenforceable by a court of competent jurisdiction, then that provision shall be interpreted to preserve the intent of the Parties if possible, and if not, then that provision will be limited or eliminated to the minimum extent necessary so that this Agreement shall otherwise remain in full force and effect and be enforceable.

15.8 No Implied License. Each Party recognizes that the other Party grants no license, by implication or otherwise, except for the licenses expressly set forth in this Agreement.

15.9 Basis of Bargain. Each Party recognizes and agrees that the warranty disclaimers and liability and remedy limitations in this Agreement are material bargained for bases of this Agreement and that they have been taken into account and reflected in determining the consideration to be given by each Party under this Agreement and in the decision by each Party to enter into this Agreement.

15.10 Counterparts. This Agreement may be executed in one or more counterparts (including by facsimile or electronic transmission), each of which shall for all purposes be deemed to be an original and all of which shall constitute the same instrument.

15.11 Bankruptcy. The Parties agree that the licenses granted hereunder are subject to Section 365(n) of the U.S. Bankruptcy Code.

**(Signature Page Follows)**



The Parties have caused their duly authorized representatives to execute and deliver this Agreement as of the Effective Date.

**AIR PRODUCTS AND CHEMICALS, INC.**

**LANDEC CORPORATION**

**By:** \_\_\_\_\_

**By:** \_\_\_\_\_

**Name:** \_\_\_\_\_

**Name:** Gary T. Steele

**Title:** \_\_\_\_\_

**Title:** President and Chief Executive Officer

**ATTACHED AND INCORPORATED BY REFERENCE EXHIBITS A THROUGH G**

**Exhibit A**  
**Patent Properties**

The Landec Patents licensed in the Exclusive Fields and Reserved Fields include but are not limited to the following:

- (1) Landec patents and patent applications relating to Landec internal docket 11551-X
    - a. US 6,199,318 Aqueous Emulsions of Crystalline Polymers for Coating Seeds
    - b. US 6,540,984 Aqueous Dispersions of Crystalline Polymers and Uses
    - c. US 20030147946 Aqueous Dispersions of Crystalline Polymers and Uses
    - d. CIP's, continuations, divisionals and foreign equivalents
  - (2) Landec patents and patent applications relating to Landec internal docket 12969-X
    - a. US 20010018484 Polymeric Thickeners for Oil-Containing Compositions
    - b. US 6,989,417 Polymeric Thickeners for Oil-Containing Compositions
    - c. CIP's, continuations, divisionals and foreign equivalents
  - (3) US 6,831,116 Polymeric Modifying Agents
  - (4) US 6,255,367 Polymeric Modifying Agents
  - (5) US 6,224,793 Encapsulated Active Materials
  - (6) All other Landec patents and patent applications to the extent that they relate to the Exclusive or Reserved Fields.
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## Exhibit B

### Work Plan

(i) "Intelimer Instruction" shall mean the instruction to APD given by Landec's V.P. of Corporate Technology (currently Steven P. Bitler) who will commit up to \*\*\* hours and Landec's Chief Operating Officer (currently David D. Taft) who will commit up to \*\*\* hours commencing on the Effective Date and continuing until May 28, 2006 (the period from the Effective Date through May 28, 2006 is sometimes referred to as the "Intelimer Instruction Period") and which shall include, without limitation:

- a) Detailed review of relevant patents, patent applications, and patent claims and trade secrets;
- b) Side Chain Crystalline (SCC) chemistry and product design fundamentals;
- c) Manufacturing process know-how;
- d) Introduction to tollers; toller process familiarization;
- e) EH&S, including regulatory and Personal Care self-regulation requirements
- f) Applications development know-how;
- g) End-use customer introductions and familiarization with on-going product development
- h) Technical service (including with customers) and manufacturing support;
- i) Other fundamental aspects of Intelimer technology estate, including regulatory compliance and registrations, and;
- j) Any other of Landec's Existing Know-How, and Proprietary Information in sufficient detail to allow APD to manufacture, use and sell the Products, including, without limitation, complete documentation, drawings, samples and audio-visual materials supporting same, in each case as reasonably necessary to permit APD to manufacture, use and sell the Products.

During the Intelimer Instruction Period, APD shall provide adequate and trained resources, equivalent to at least one full time staff person, to receive the Intelimer Instruction to assure that it is received with clear understanding. Landec will provide written documentation of the Intelimer Instruction to assist in the transfer of copies of the Licensed Technology. APD will return with a written list of questions on the Licensed Technology within thirty (30) days of the Effective Date to allow Landec adequate time to respond to these questions before May 28, 2006.

To complete the Intelimer Instruction Landec's V.P. of Corporate Technology and Landec's Chief Operating Officer will visit APD's headquarter facility in Allentown, PA. to assure delivery of Intelimer Instruction a minimum of two times before May 28, 2006.

(ii) R&D Plan: Within thirty (30) days of the Effective Date and during the R&D Period, the Parties agree to meet to develop a detailed R&D plan for Year 1 that can be modified from time to time, preferably during the quarterly review meetings, by agreement of the parties but at the direction of APD. Annual work plans for Years 2 and 3 will be developed at the appropriate time.

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\* Certain information on this page has been omitted and filed separately with the Commission. Confidential treatment has been requested with respect to the omitted portions.

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As a part of the R&D Plan, Landec will detail specific research and development activities to be performed and APD will detail any assistance it will provide for the Work Plan as well as application development, technical services, customer support and manufacturing support APD requires from Landec. During the R&D Period, Landec shall provide the equivalent of at least three (3) full time staff persons as well as appropriate facilities to provide such activities. APD assistance will be determined by APD and will include the resources of sales, business development, application development technical service and process engineering staffing deemed appropriate required to meet the R&D Plan and to assist in accomplishing the Work Plan as detailed and modified according to Section 3.1. The parties agree to collaborate to prepare detailed plans, objectives and milestones of both parties to meet the short term and long term objectives of the R&D Plan.

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## Exhibit C

### Territories in which Licensed Mark is Registered

I. Landec has registered the INTELIMER mark as:

001 – Temperature sensitive polymers for use in manufacture of films, coatings and adhesives,

In the following countries:

United States: Registration Number 1,653,373

Canada: Registration Number 383,823

Japan: Registration Numbers 4095860 (English), 4100755 (English), 4124857 (Katakana), 423935 (Katakana)

II. Landec is permitted to grant APD a license under the following trademarks which Landec's eye care partner, Alcon, has registered the INTELIMER mark as:

Class 1 – Polymers alone and in combination with other ingredients for the manufacture of films, coatings, adhesives and medical devices,

In the following countries:

Algeria, Argentina, Armenia, Australia, Austria, Azerbaijan, Belarus, Benelux, Bolivia, Brazil, Bulgaria, Chile, China, Colombia, Costa Rica, Croatia, Cuba, Denmark, Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Finland, France, Germany, Greece, Guatemala, Honduras, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Kazakhstan, Korea North, Korea South, Kyrgyzstan, Latvia, Lebanon, Liechtenstein, Lithuania, Macedonia, Malaysia, Mexico, Moldova, Monaco, Morocco, New Zealand, Nicaragua, Norway, Pakistan, Panama, Paraguay, Peru, Poland, Portugal, Romania, Russian Federation, San Marino, Saudi Arabia, Serbia-Montenegro, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Taiwan, Tajikistan, Thailand, Turkey, Turkmenistan, Ukraine, United Kingdom, Uruguay, Uzbekistan, Venezuela, Vietnam, WIPO.

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**Exhibit D**

**\*\*\* Field Customer Sales Forecasts**

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\* Certain information on this page has been omitted and filed separately with the Commission. Confidential treatment has been requested with respect to the omitted portions.

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**Exhibit E**

**See attached patent list.**

\* \* \* \*

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\* Certain information on this page has been omitted and filed separately with the Commission. Confidential treatment has been requested with respect to the omitted portions.

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**Exhibit F**  
**Reserved**

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**Exhibit G**

**APD Fields Customer Sales Forecasts**

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\* Certain information on this page has been omitted and filed separately with the Commission. Confidential treatment has been requested with respect to the omitted portions.

**LANDEC CORPORATION  
2005 STOCK INCENTIVE PLAN  
NOTICE OF STOCK OPTION GRANT**

Optionee:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

You have been granted an option (the "Option") to purchase Common Stock of Landec Corporation (the "Company"), as follows:

Date of Grant: \_\_\_\_\_  
Exercise Price Per Share: \_\_\_\_\_  
Total Number of Shares Granted: \_\_\_\_\_  
Total Exercise Price: \_\_\_\_\_  
Type of Option: \_\_\_\_\_  
Term/Expiration Date: \_\_\_\_\_  
Vesting Commencement Date: \_\_\_\_\_

Vesting Schedule: So long as your Service continues, the Shares underlying this Option shall vest and become exercisable in accordance with the following schedule: [1/36th of the total number of Shares subject to this Option shall vest and become exercisable on each monthly anniversary thereafter.]



Termination Period:

This Option may be exercised for six months after termination of your Service except as set forth in Section 4 of the Stock Option Agreement (but in no event later than the Expiration Date). Optionee is responsible for keeping track of the exercise period following a termination of his or her Service for any reason. The Company will not provide further notice of such period.

Unless otherwise defined in this Notice of Stock Option Grant, the terms used herein shall have the meanings assigned to them in the Plan.

By your signature and the signature of the Company's representative below, you and the Company agree that this Option is granted under and governed by the terms and conditions of the Landec Corporation 2005 Stock Incentive Plan and the Stock Option Agreement, all of which are attached to, and made a part of, this document.

In addition, you agree and acknowledge that your rights to any Shares underlying this Option will be earned only as you provide Service over time, that the grant of the Option is not as consideration for services you rendered to the Company (or any Parent, Subsidiary, or Affiliate), prior to your Vesting Commencement Date, and that nothing in this Notice of Stock Option Grant or the attached documents confers upon you any right to continue your employment or consulting relationship with the Company (or any Parent, Subsidiary, or Affiliate) for any period of time, nor does it interfere in any way with your right or the Company's (or any Parent's, Subsidiary's, or Affiliate's) right to terminate that relationship at any time, for any reason, with or without cause.

OPTIONEE:

LANDEC CORPORATION

\_\_\_\_\_  
Signature

By: \_\_\_\_\_

\_\_\_\_\_  
Print Name

Title: \_\_\_\_\_

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**LANDEC CORPORATION  
2005 STOCK INCENTIVE PLAN  
STOCK OPTION AGREEMENT**

1. **Grant of Option.** Landec Corporation, a California corporation (the "Company"), hereby grants to the Optionee named in the Notice of Stock Option Grant attached to this Stock Option Agreement (the "Optionee"), an option (the "Option") to purchase the total number of shares of Common Stock (the "Shares") set forth in the Notice of Stock Option Grant (the "Notice"), at the exercise price per Share set forth in the Notice (the "Exercise Price") subject to the terms, definitions and provisions of the 2005 Stock Incentive Plan (the "Plan"), which is incorporated in this Stock Option Agreement (the "Agreement") by reference. Unless otherwise defined in this Agreement, the terms used in this Agreement shall have the meanings defined in the Plan.

This Option is intended to be an Incentive Stock Option as defined in Section 422 of the Code only to the extent so designated in the Notice, and to the extent it is not so designated or to the extent the Option does not qualify as an Incentive Stock Option, it is intended to be a Nonstatutory Stock Option. Notwithstanding the foregoing, even if designated as an Incentive Stock Option, in the event that the Shares subject to this Option (and all other Incentive Stock Options granted to Optionee by the Company or any Parent or Subsidiary, including under other plans of the Company) that first become exercisable in any calendar year have an aggregate fair market value (determined for each Share as of the date of grant of the option covering such Share) in excess of \$100,000, the Shares in excess of \$100,000 shall be treated as subject to a Nonstatutory Stock Option in accordance applicable law.

2. **Exercise of Option.** This Option shall be exercisable during its term in accordance with the Vesting Schedule set out in the Notice and with the applicable provisions of the Plan as follows:

(a) **Right to Exercise.**

(i) This Option may not be exercised for a fraction of a share.

(ii) In the event of Optionee's termination of Service, the exercisability of the Option shall be governed by Section 4 below, subject to the limitations contained in paragraph (iii) below.

(iii) In no event may this Option be exercised after the Expiration Date as set forth in the Notice.

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(b) **Method of Exercise.**

(i) This Option may be exercised by delivering to the Company a fully executed Notice of Exercise (in the form attached as Exhibit A) which shall state the Optionee's election to exercise the Option, the number of Shares in respect of which the Option is being exercised, and such other representations and agreements as to the holder's investment intent with respect to such Shares as may be required by the Company pursuant to the provisions of the Plan. Such written notice shall be signed by Optionee and shall be delivered to the Company by such means as are determined to constitute adequate delivery by the Plan Administrator in its discretion. The Notice of Exercise shall be accompanied by payment of the Exercise Price. This Option shall be deemed to be exercised upon receipt by the Company of such fully executed Notice of Exercise accompanied by the Exercise Price.

(ii) As a condition to the exercise of this Option, Optionee agrees to make adequate provision for any applicable federal, state or other tax withholding obligations, if any, which arise upon the exercise of the Option or disposition of Shares, whether by withholding, direct payment to the Company, or otherwise.

(iii) The Company is not obligated, and will have no liability for failure, to issue or deliver any Shares upon exercise of the Option unless such issuance or delivery would comply with all applicable laws, with such compliance determined by the Company in consultation with its legal counsel. This Option may not be exercised if the issuance of such Shares upon such exercise or the method of payment of consideration for such shares would constitute a violation of any applicable federal or state securities or other law or regulation, including any rule under Part 221 of Title 12 of the Code of Federal Regulations as promulgated by the Federal Reserve Board. As a condition to the exercise of this Option, the Company may require Optionee to make any representation and warranty to the Company as may be required by any applicable laws. Assuming such compliance, for income tax purposes the Shares shall be considered transferred to Optionee on the date on which the Option is exercised with respect to such Shares.

3. **Method of Payment.** Payment of the Exercise Price shall be by any of the following, or a combination of the following, at the election of Optionee: (a) cash, (b) check, (c) surrender of other Shares, provided that the Company may, in its sole discretion, require that Shares tendered for payment be previously held by the Optionee for a minimum duration, or (d) Cashless Exercise.

4. **Termination of Relationship.** Following the date of termination of Optionee's Service for any reason (the "Termination Date"), Optionee may exercise the Option only as set forth in the Notice and this Section 4. To the extent that Optionee does not exercise this Option within the Termination Period set forth in the Notice or the termination periods set forth below, the Option shall terminate in its entirety. In no event, may any Option be exercised after the Expiration Date of the Option as set forth in the Notice. In the event of termination of Optionee's Service other than as a result of Optionee's Disability or death or for Cause, Optionee may, to the extent Optionee is

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vested in the Option Shares at the Termination Date, exercise this Option during the Termination Period set forth in the Notice. In the event of any other termination, Optionee may exercise the Option only as described below:

(a) **Termination upon Disability of Optionee.** In the event of termination of Optionee's Service as a result of Optionee's Disability, Optionee may, but only within six months from the Termination Date, exercise this Option to the extent Optionee was vested in the Option Shares as of such Termination Date.

(b) **Death of Optionee.** In the event of the death of Optionee while in Service, the Option may be exercised at any time within six months following the date of death by Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent Optionee was vested in the Option Shares as of the Termination Date.

(c) **Termination for Cause.** In the event Optionee's Service is terminated for Cause, the Option shall terminate immediately upon such termination for Cause. In the event Optionee's employment or consulting relationship with the Company is suspended pending investigation of whether such relationship shall be terminated for Cause, all Optionee's rights under the Option, including the right to exercise the Option, shall be suspended during the investigation period.

5. **Non-Transferability of Option.** This Option may not be transferred in any manner otherwise than by will or by the laws of descent or distribution. The designation of a beneficiary does not constitute a transfer. This Option may be exercised during the lifetime of Optionee only by Optionee. The terms of this Option shall be binding upon the executors, administrators, heirs, successors and assigns of Optionee.

6. **No Employment Rights.** Optionee understands and agrees that the vesting of Shares pursuant to the Vesting Schedule is earned only by continuing as an Employee or Consultant at the will of the Company (or any Parent, Subsidiary, or Affiliate) and not through the act of being hired, being granted this Option or acquiring Shares under this Agreement. Optionee further acknowledges and agrees that nothing in this Agreement, nor in the Plan which is incorporated in this Agreement by reference, shall confer upon Optionee any right with respect to continuation as an Employee or Consultant with the Company (or any Parent, Subsidiary, or Affiliate), nor shall it interfere in any way with his or her right or the Company's (or any Parent's, Subsidiary's, or Affiliate's) right to terminate his or her employment or consulting relationship at any time, with or without cause.

7. **Effect of Agreement.** In the event of a conflict between the terms and provisions of the Plan and the terms and provisions of the Notice and this Agreement, the Plan terms and provisions shall prevail. The Option, including the Plan, constitutes the entire agreement between Optionee and the Company on the subject matter hereof and supersedes all proposals, written or oral, and all other communications between the parties relating to such subject matter.

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8. **Applicable Law**. This Agreement will be interpreted and enforced under the laws of the State of California without regard to the conflict of laws principles thereof.

9. **Signature**. This Agreement shall be deemed executed by the Company and Optionee upon execution by such parties of the Notice attached to this Agreement.

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**EXHIBIT A**  
**NOTICE OF EXERCISE**

To: Landec Corporation  
Attn: Administrator of the 2005 Stock Incentive Plan  
Subject: Notice of Intention to Exercise Stock Option

This Notice of Exercise constitutes official notice that the undersigned intends to exercise Optionee's option to purchase \_\_\_ shares of Landec Corporation Common Stock, under and pursuant to the Company's 2005 Stock Incentive Plan (the "Plan") and the Notice of Stock Option and Stock Option Agreement (the "Agreement") dated \_\_\_, as follows:

Number of Shares: \_\_\_\_\_

Exercise Price per Share: \_\_\_\_\_

Total Exercise Price: \_\_\_\_\_

Method of Payment  
of Exercise Price: \_\_\_\_\_

The shares should be registered in the name (s) of:

\_\_\_\_\_ and

\_\_\_\_\_,<sup>1</sup>

By signing below, I hereby agree to be bound by all of the terms and conditions set forth in the Plan and the Agreement. If applicable, proof of my right to purchase the shares pursuant to the Plan and the Agreement is enclosed.<sup>2</sup>

Dated: \_\_\_\_\_

\_\_\_\_\_  
(Signature)

\_\_\_\_\_  
(Please Print Name)

\_\_\_\_\_

\_\_\_\_\_  
(Full Address)

\_\_\_\_\_  
(Signature)<sup>3</sup>

\_\_\_\_\_  
(Please Print Name)

\_\_\_\_\_

\_\_\_\_\_  
(Full Address)

<sup>1</sup> If more than one name is listed, please specify whether the owners will hold the shares as community property or as joint tenants with the right of survivorship.

<sup>2</sup> Applicable if someone other than the Optionee (e.g., a death beneficiary) is exercising the stock option.

<sup>3</sup> Each person in whose name shares are to be registered must sign this Notice of Exercise.



LANDEC CORPORATION  
2005 STOCK INCENTIVE PLAN

STOCK UNIT AGREEMENT

This Stock Unit Agreement (the "Agreement") is made and entered into as of \_\_\_, 20\_\_\_ by and between Landec Corporation, a California corporation (the "Company"), and \_\_\_ pursuant to the Landec Corporation 2005 Stock Incentive Plan (the "Plan"). To the extent any capitalized terms used in this Agreement are not defined, they shall have the meaning ascribed to them in the Plan, which is attached to, and made a part of, this Agreement. In the event of a conflict between the terms and provisions of the Plan and the terms and provisions of this Agreement, the Plan terms and provisions shall prevail.

In consideration of the mutual agreements herein contained and intending to be legally bound hereby, the parties agree as follows:

1. **Restricted Stock Units.** Pursuant to the Plan, the Company hereby grants to you, and you hereby accept from the Company, \_\_\_ Stock Units (the "Restricted Stock Units"), on the terms and conditions set forth herein and in the Plan.
2. **Vesting of Restricted Stock Units.** So long as your Service continues, the Restricted Stock Units shall vest in accordance with the following schedule: 100% of the total number of Restricted Stock Units shall vest on the [third anniversary] of the date of grant.
3. **Termination of Service.** In the event of the termination of your Service for any reason, all unvested Restricted Stock Units shall be immediately forfeited without consideration.
4. **Settlement of Restricted Stock Units.** Restricted Stock Units shall be automatically settled in Shares upon vesting pursuant to Section 2 above, provided that the Company shall have no obligation to issue Shares pursuant to this Agreement unless and until you have satisfied any applicable tax withholding obligations pursuant to Section 5 below. Issuance of such Shares shall be made as soon as reasonably practicable following the applicable vesting date.
5. **Withholding Taxes.** You agree to make arrangements satisfactory to the Company for the satisfaction of any applicable withholding tax obligations that arise in connection with the Restricted Stock Units. The Company shall not be required to issue Shares pursuant to this Agreement unless and until such obligations are satisfied.
6. **Tax Advice.** You represent, warrant and acknowledge that the Company has made no warranties or representations to you with respect to the income tax consequences of the transactions contemplated by this Agreement, and you are in no manner relying on the Company or the Company's representatives for an assessment of such tax consequences. YOU UNDERSTAND THAT THE TAX LAWS AND

REGULATIONS ARE SUBJECT TO CHANGE. YOU SHOULD CONSULT YOUR OWN TAX ADVISOR REGARDING ANY RESTRICTED STOCK UNITS. NOTHING STATED HEREIN IS INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF AVOIDING TAXPAYER PENALTIES.

7. **Non-Transferability of Restricted Stock Units.** Except as permitted by applicable law, Restricted Stock Units which have not vested pursuant to Section 2 above shall not be anticipated, assigned, attached, gamished, optioned, transferred or made subject to any creditor's process, whether voluntarily or involuntarily or by the operation of law. However, this Section 7 shall not preclude you from designating a beneficiary who will receive the Shares underlying any vested Restricted Stock Units in the event of the your death, nor shall it preclude a transfer of such Shares by will or by the laws of descent and distribution.

8. **No Employment Rights.** You understand, acknowledge and agree that nothing in this Agreement shall affect in any manner whatsoever the status of your Service or the right or power of the Company (or any Parent, Subsidiary, or Affiliate) to terminate your employment or consulting relationship with the Company (or any Parent, Subsidiary, or Affiliate) at any time, for any such reason, with or without cause, in accordance with applicable law.

9. **Voting and Other Rights.** Subject to the terms of this Agreement, you shall not have any voting rights or any other rights and privileges of a shareholder of the Company unless and until the Restricted Stock Units are settled upon vesting.

10. **Governing Law.** This Agreement shall be governed by and construed in accordance with the laws of the State of California without regard to the conflict of laws principles thereof.

11. **Notices.** All notices, communications and documents under this Agreement shall be in writing. All notices, communications, and documents directed to the Company and related to the Agreement, if not delivered by hand, shall be mailed to the Company's principal executive office, Attention: Stock Administration. The current address of the Company's principal executive office is:

Landec Corporation  
3603 Haven Avenue  
Menlo Park, CA 94025

All notices, communications, and documents intended for you and related to this Agreement, if not delivered by hand, shall be mailed to your address shown on the last page of this Agreement or such other address as you may specify by notice complying with this section. Notices, communications, and documents not delivered by hand shall be mailed by registered or certified mail, return receipt requested, postage prepaid. All

mailings and deliveries related to this Agreement shall be deemed received only when actually received.

12. **Binding Effect.** Subject to the limitations set forth in this Agreement, this Agreement shall be binding upon, and inure to the benefit of, the executors, administrators, heirs, legal representatives, successors, and assigns of the parties hereto.

13. **Counterparts.** This Agreement may be signed in counterparts with the same effect as if the signature to each such counterpart were upon a single instrument, and all counterparts shall be deemed an original of this Agreement.

14. **Severability.** If any provision of this Agreement is held to be unenforceable for any reason, it shall be adjusted rather than voided, if possible, in order to achieve the intent of the parties to the extent possible. In any event, all other provisions of this Agreement shall be deemed valid and enforceable to the full extent possible.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on this \_\_\_ day of \_\_\_, 20\_\_\_.

**LANDEC CORPORATION**

By: \_\_\_\_\_  
*(Signature)*

Name: \_\_\_\_\_

Title: \_\_\_\_\_

**RECIPIENT:**

\_\_\_\_\_

By: \_\_\_\_\_  
*(Signature)*

Address: \_\_\_\_\_

\_\_\_\_\_

Telephone Number: \_\_\_\_\_

Email Address: \_\_\_\_\_

I, \_\_\_\_\_, spouse of \_\_\_\_\_, have read and hereby approve the foregoing Agreement. In consideration of the Company's granting my spouse the right to the Restricted Stock Units as set forth in the Agreement, I hereby agree to be bound irrevocably by the Agreement and further agree that any community property or other such interest that I may have in the Restricted Stock Units and the underlying Shares shall hereby be similarly bound by the Agreement. I hereby appoint my spouse as my attorney-in-fact with respect to any amendment or exercise of any rights under the Agreement.

\_\_\_\_\_  
Spouse of Recipient

**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 and Form S-3 Nos. 333-95531 and 333-117895) 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 and pertaining to shares of common stock issued to selling shareholders of Apio, Inc. and to individual investors of our reports dated July 14, 2006, with respect to the consolidated financial statements of Landec Corporation, Landec Corporation management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Landec Corporation, included in the Annual Report (Form 10-K) for the year ended May 28, 2006.

/s/ ERNST & YOUNG LLP

San Jose, California  
July 26, 2006

## 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: July 27, 2006

/s/ Gary T. Steele

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Gary T. Steele  
President and Chief Executive Officer

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: July 27, 2006

/s/ Gregory S. Skinner

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Gregory S. Skinner  
Vice President of Finance and Administration  
and Chief Financial Officer

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 28, 2006 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: July 27, 2006

/s/ Gary T. Steele

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Gary T. Steele  
*Chief Executive Officer and President*  
*(Principal Executive Officer)*

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\* 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.



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 28, 2006 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: July 27, 2006

/s/ Gregory S. Skinner  
Gregory S. Skinner  
*Vice President and Chief Financial Officer*  
*(Principal Accounting Officer)*

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\* 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.