

# LANDEC CORP \CA\

## FORM 10-Q (Quarterly Report)

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Industry Chemicals - Plastics & Rubber  
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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

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

For the Fiscal Quarter Ended November 28, 2004, or

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

For the Transition period from        to        .

Commission file number: 0-27446

### LANDEC CORPORATION

(Exact name of registrant as specified in its charter)

**California**

(State or other jurisdiction of  
incorporation or organization)

**94-3025618**

(IRS Employer  
Identification Number)

**3603 Haven Avenue**

**Menlo Park, California 94025**

(Address of principal executive offices)

Registrant's telephone number, including area code:

**(650) 306-1650**

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

Yes

No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

As of December 20, 2004, there were 23,995,862 shares of Common Stock outstanding.

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**LANDEC CORPORATION**

FORM 10-Q For the Fiscal Quarter Ended November 28, 2004

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**PART I. FINANCIAL INFORMATION**

**Item 1 . Financial Statements**

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

	<u>November 28, 2004</u>		<u>May 30, 2004</u>
	(Unaudited)		
<b>ASSETS</b>			
Current Assets:			
Cash and cash equivalents	\$ 6,215	\$	6,458
Accounts receivable, less allowance for doubtful accounts of \$240 and \$265 at November 28, 2004 and May 30, 2004	15,401		14,851
Accounts receivable, related party	343		498
Inventory	17,256		11,227
Notes and advances receivable	1,042		1,144
Notes receivable, related party	139		306
Prepaid expenses and other current assets	1,737		1,527
Total Current Assets	<u>42,133</u>		<u>36,011</u>
Property and equipment, net	18,771		18,341
Goodwill, net	25,987		25,987
Trademarks and other intangible, net	11,904		11,737
Notes receivable	504		605
Notes receivable, related party	55		96
Other assets	154		230
Total Assets	<u>\$ 99,508</u>	\$	<u>93,007</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current Liabilities:			
Accounts payable	\$ 16,466	\$	14,960
Related party payables	193		430
Accrued compensation	1,653		1,570
Other accrued liabilities	2,848		2,506
Deferred revenue	3,193		807
Lines of credit	4,192		5,317
Current maturities of long term debt	1,793		1,505
Total Current Liabilities	<u>30,338</u>		<u>27,095</u>
Long term debt, less current maturities	2,806		2,174
Other liabilities	593		637
Minority interest	1,281		1,552
Shareholders' Equity:			
Common stock	121,282		116,841
Accumulated deficit	<u>(56,792)</u>		<u>(55,292)</u>
Total Shareholders' Equity	<u>64,490</u>		<u>61,549</u>
Total Liabilities and Shareholders' Equity	<u>\$ 99,508</u>	\$	<u>93,007</u>

*See accompanying notes.*

**LANDEC CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	November 28, 2004	November 30, 2003	November 28, 2004	November 30, 2003
Revenues:				
Product sales	\$ 49,696	\$ 41,989	\$ 95,252	\$ 80,816
Services revenue	—	9	11	2,083
Services revenue, related party	876	1,063	2,027	1,826
Research, development and royalty revenues	23	60	63	177
Royalty revenues, related party	54	122	128	122
License fees	22	22	44	44
Total revenues	50,671	43,265	97,525	85,068
Cost of revenue:				
Cost of product sales	42,748	36,619	81,236	69,403
Cost of product sales, related party	1,506	1,177	3,395	2,285
Cost of services revenue	421	439	1,158	2,269
Total cost of revenue	44,675	38,235	85,789	73,957
Gross profit	5,996	5,030	11,736	11,111
Operating costs and expenses:				
Research and development	685	997	1,489	1,918
Selling, general and administrative	5,946	5,221	11,321	10,704
Total operating costs and expenses	6,631	6,218	12,810	12,622
Operating loss	(635)	(1,188)	(1,074)	(1,511)
Interest income	9	38	19	91
Interest expense	(87)	(259)	(205)	(533)
Other expense	(95)	(174)	(240)	(254)
Net loss	(808)	(1,583)	(1,500)	(2,207)
Dividends on Series B preferred stock	—	(115)	—	(228)
Net loss applicable to common shareholders	\$ (808)	\$ (1,698)	\$ (1,500)	\$ (2,435)
Basic and diluted net loss per share	\$ (0.03)	\$ (0.08)	\$ (0.06)	\$ (0.11)
Shares used in per share computation	23,595	21,231	23,396	21,215

*See accompanying notes.*

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

	Six Months Ended	
	November 28, 2004	November 30, 2003
Cash flows from operating activities:		
Net loss	\$ (1,500)	\$ (2,207)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,703	1,753
Write down of goodwill	—	120
Gain on disposal of property and equipment	39	—
Minority interest	279	321
Changes in current assets and liabilities:		
Accounts receivable, net	(395)	4,193
Inventory	(6,029)	(4,955)
Notes and advances receivable	411	1,162
Prepaid expenses and other current assets	(210)	(1,485)
Accounts payable	1,506	(2,079)
Grower payables	—	(3,234)
Related party payables	(237)	(248)
Accrued compensation	83	(51)
Other accrued liabilities	342	(790)
Deferred revenue	2,386	2,656
Net cash used in operating activities	<u>(1,622)</u>	<u>(4,844)</u>
Cash flows from investing activities:		
Purchases of property and equipment	(2,089)	(1,699)
Change in other assets and liabilities	(218)	(279)
Change in restricted cash	—	657
Net cash used in investing activities	<u>(2,307)</u>	<u>(1,321)</u>
Cash flows from financing activities:		
Proceeds from sale of common stock	4,441	237
Borrowings on lines of credit	55,936	53,480
Payments on lines of credit	(57,061)	(47,563)
Payments on long term debt	(280)	(1,238)
Proceeds from issuance of long term debt	1,200	—
Distributions to minority interest	(550)	(154)
Net cash provided by financing activities	<u>3,686</u>	<u>4,762</u>
Net decrease in cash and cash equivalents	(243)	(1,403)
Cash and cash equivalents at beginning of period	6,458	3,699
Cash and cash equivalents at end of period	<u>\$ 6,215</u>	<u>\$ 2,296</u>
Supplemental schedule of noncash investing and financing activities:		
Sale of assets and services for notes receivable	\$ —	\$ 239
Issuance of Series B preferred stock as dividends to Series B preferred stockholders	\$ —	\$ 228

*See accompanying notes.*

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

**1. Basis of Presentation**

Landec Corporation and its subsidiaries (“Landec” or the “Company”) design, develop, manufacture, and sell temperature-activated and other specialty polymer products for a variety of food products, agricultural products, and licensed partner applications. The Company markets and distributes hybrid corn seed to farmers through its Landec Ag, Inc. (“Landec Ag”) subsidiary and specialty packaged fresh-cut vegetables and whole produce to retailers, club stores, and foodservice companies primarily in the United States and Asia through its Apio, Inc. (“Apio”) subsidiary.

The accompanying unaudited consolidated financial statements of Landec have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made which are necessary to present fairly the financial position at November 28, 2004 and the results of operations and cash flows for all periods presented. Although Landec believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in financial statements and related footnotes prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted per the rules and regulations of the Securities and Exchange Commission. The accompanying financial data should be reviewed in conjunction with the audited financial statements and accompanying notes included in Landec’s Annual Report on Form 10-K for the fiscal year ended May 30, 2004.

The results of operations for the three and six months ended November 28, 2004 are not necessarily indicative of the results that may be expected for an entire fiscal year. For instance, due to the cyclical nature of the corn seed industry, a significant portion of Landec Ag revenues and profits will be concentrated over a few months during the spring planting season (generally during Landec’s third and fourth fiscal quarters). In addition, Landec Ag purchases corn seed and collects cash deposits from farmers in advance of shipping the corn during the Company’s third and fourth quarters. The increased levels of inventory and deferred revenue at November 28, 2004 compared to May 30, 2004 reflect the seasonal nature of Landec Ag’s seed business. In February 2003, the Company changed its fiscal year end from a fiscal year including 52 or 53 weeks that ended on the last Sunday in October to a fiscal year including 52 or 53 weeks that ends on the last Sunday in May.

**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, as well as investments in farming activities, 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.

**Recent Accounting Pronouncements**

On December 16, 2004, the FASB issued an amendment to FASB Statement No. 123, *Accounting for Stock-Based Compensation*. The amendment requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based on their fair values. The amendment is effective for the Company in the first quarter of fiscal year 2006. The Company intends to continue to grant stock-

based compensation to employees, and the adoption of the new standard may have a material impact on the future results of operations.

## **Reclassifications**

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

### **2. Exit of Domestic Commodity Vegetable Business**

Effective June 30, 2003, the Company exited the selling of domestic commodity vegetable products and sold certain assets associated with this business to Apio Fresh LLC (“Apio Fresh”). Apio Fresh is owned by a group of entities and persons that supply produce to Apio. One of the owners of Apio Fresh is the Apio CEO (see Note 8). Under the terms of the sale, Apio Fresh purchased certain equipment and carton inventory from the Company at their net book value of approximately \$410,000 in exchange for notes receivables due in monthly installments over 24 months. In addition, Apio will be providing information technology service to Apio Fresh for 36 months in exchange for a note receivable for \$235,000. In connection with the sale, Apio Fresh will pay the Company an on-going royalty fee per carton sold for the use of Apio’s brand names. Apio Fresh and its owner growers also entered into a long-term supply agreement with the Company to supply produce to Apio for its fresh-cut, value-added business. As a result of the sale, the Company recorded during the first quarter of fiscal year 2004, a write down of goodwill of \$120,000 allocable to this business.

### **3. Licensing Agreement**

On September 3, 2004, the Company entered into a multi-year joint technology and licensing agreement with Chiquita Brands International, Inc. (“Chiquita”) to provide Landec’s Intelimer packaging technology for Chiquita bananas. The Company expects to start selling its technology products to Chiquita during the second half of fiscal year 2005. The revenues from this agreement are not expected to be material in the current fiscal year. In addition, the two companies entered into a stock purchase agreement, whereby the Company sold to Chiquita 486,111 shares of Landec Common Stock on October 14, 2004 for \$3.5 million in cash.

### **4. Stock-Based Compensation**

As permitted by Statement of Financial Accounting Standards No. 123, “Accounting for Stock-Based Compensation,” (SFAS 123), as amended by Statement of Financial Accounting Standards No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure,” (SFAS 148), the Company elected to continue to apply the provisions of Accounting Principle Board Opinion No. 25, “Accounting for Stock Issued to Employees,” (APB 25) and related interpretations in accounting for its employee stock option and stock purchase plans. The Company is not required under APB 25 and related interpretations to recognize compensation expense in connection with its employee stock option and stock purchase plans, unless the exercise price of the Company’s employee stock options is less than the market price of the underlying stock at the date of grant.

Pro forma information regarding net loss and net loss per share is required by SFAS 148 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS 123. The fair value for these options was estimated at the date of grant using the Black-Scholes option valuation model with the following weighted average assumptions: risk-free interest rates ranging from 3.35% to 3.47% for the three months ended November 28, 2004, 3.18% to 3.29% for the three months November 30, 2003; 3.35% to 3.93% for the six months ended November 28, 2004, and 2.27% to 3.37% for the six months ended November 30, 2003; a dividend yield of 0.0% for the three and six months ended November 28, 2004 and November 30, 2003; a volatility factor of the expected market price of the Company’s common stock of 0.59 and 0.77 as of November 28, 2004 and November 30, 2003, respectively; and a weighted average expected life of the options of 4.61 years and 5 . 14 years for the three and six months ended November 28, 2004 and November 30, 2003, respectively.



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

	Three Months Ended		Six Months Ended	
	November 28, 2004	November 30, 2003	November 28, 2004	November 30, 2003
Net loss	\$ (808)	\$ (1,583)	\$ (1,500)	\$ (2,207)
Deduct:				
Stock-based employee expense determined under SFAS 123	(487)	(380)	(664)	(568)
Pro forma net loss	\$ (1,295)	\$ (1,963)	\$ (2,164)	\$ (2,775)
Basic and diluted net loss per share – as reported	\$ (0.03)	\$ (0.08)	\$ (0.06)	\$ (0.11)
Basic and diluted pro forma net loss per share	\$ (0.05)	\$ (0.10)	\$ (0.09)	\$ (0.14)

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options and employee stock purchase plans have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair market value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options, nor do they necessarily represent the effects of employee stock options on reported net income (loss) for future years.

## 5. Goodwill and Other Intangibles

The Company is required under SFAS 142 to review goodwill and indefinite lived intangible assets at least annually. During the six months ended November 28, 2004, the Company completed its third 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 November 28, 2004.

## 6. Inventories

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

	November 28, 2004	May 30, 2004
Finished goods	\$ 11,881	\$ 7,350
Raw material	5,324	3,805
Work in process	51	72
Total	\$ 17,256	\$ 11,227

## **7. Debt**

On September 1, 2004, Apio entered into 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 prior equipment line of credit (collectively the "Loan Agreement") with Wells Fargo Bank N.A. Outstanding amounts under the Loan Agreement bear interest at either the prime rate or the LIBOR adjustable rate plus 2.25% (4.21% at November 28, 2004). The Loan Agreement contains certain restrictive covenants, which requires Apio to meet certain financial tests including, minimum levels of net income, maximum leverage ratio, minimum net worth and maximum capital expenditures. The Loan Agreement also affects the ability of Landec to receive payments on debt owed by Apio to Landec. Landec has pledged substantially all of the assets of Apio to secure the lines with Wells Fargo Bank. Concurrently with entering into this agreement with Wells Fargo Bank, the Company paid off and terminated its lines of credit with Wells Fargo Business Credit, Inc. At November 28, 2004, no amounts were outstanding under the revolving line or credit or the equipment line of credit.

## **8. Related Party**

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 Apio Fresh for sale to third parties. Revenues, cost of product sales and the resulting payable and the note receivable from advances for ground lease payments, crop and harvesting costs, are classified as related party in the accompanying financial statements as of November 28, 2004 and May 30, 2004 and for the three and six months ended November 28, 2004 and November 30, 2003.

Apio leases, for approximately \$1.0 million 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.

Apio's domestic commodity vegetable business was sold to Apio Fresh, effective June 30, 2003. The Apio CEO is a 12.5% owner in Apio Fresh. During the three and six months ended November 28, 2004, the Company recognized revenues of \$28,000 and \$206,000 respectively, from the sale of products to Apio Fresh and royalty revenue of \$54,000 and \$128,000 respectively, from the use by Apio Fresh of Apio's trademarks. The related accounts receivable from Apio Fresh are classified as related party in the accompanying financial statements as of November 28, 2004 and May 30, 2004.

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 the minority interest liability as of November 28, 2004 and May 30, 2004 is \$184,000 and \$214,000, respectively, owed to the Apio CEO.

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

## **9. Comprehensive Income / Loss**

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

## **10. Shareholders Equity**

During the three and six months ended November 28, 2004, 180,918 and 220,402 shares of Common Stock, respectively, were issued upon the exercise of options under the Company's stock option plans. In addition, the Company sold to Chiquita 486,111 shares of Landec Common Stock on October 14, 2004 for \$3.5 million in cash (see Note 3).

## 11. 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 specialty packaged whole and fresh-cut vegetables that incorporate the Intelimer<sup>®</sup> based specialty packaging for the retail grocery, club store and food services industry. In June 2003, the Company exited the selling of domestic commodity vegetable products (see Note 2). The Agricultural Seed Technology segment markets and distributes hybrid seed corn to the farming industry and is developing seed coatings using Landec's proprietary Intelimer polymers. 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 and corporate operating costs. All of the assets of the Company are located within the United States of America.

Operations by Business Segment (in thousands):

	<u>Food Products Technology</u>	<u>Agricultural Seed Technology</u>	<u>Corporate and Other</u>	<u>TOTAL</u>
<u>Three months ended November 28, 2004</u>				
Net revenues	\$ 50,594	\$ 7	\$ 70	\$ 50,671
International sales	\$ 18,465	\$ —	\$ —	\$ 18,465
Gross profit	\$ 5,865	\$ 76	\$ 55	\$ 5,996
Net income (loss)	\$ 1,474	\$ (2,320)	\$ 38	\$ (808)
Interest expense	\$ 29	\$ 58	\$ —	\$ 87
Interest income	\$ 7	\$ —	\$ 2	\$ 9
Depreciation and amortization	\$ 718	\$ 116	\$ 25	\$ 859
<u>Three months ended November 30, 2003</u>				
Net revenues	\$ 43,137	\$ 19	\$ 109	\$ 43,265
International sales	\$ 15,871	\$ —	\$ —	\$ 15,871
Gross profit	\$ 4,936	\$ 7	\$ 87	\$ 5,030
Net income (loss)	\$ 864	\$ (2,332)	\$ (115)	\$ (1,583)
Interest expense	\$ 191	\$ 68	\$ —	\$ 259
Interest income	\$ 36	\$ —	\$ 2	\$ 38
Depreciation and amortization	\$ 700	\$ 107	\$ 47	\$ 854
<u>Six months ended November 28, 2004</u>				
Net revenues	\$ 97,269	\$ 105	\$ 151	\$ 97,525
International sales	\$ 36,183	\$ —	\$ —	\$ 36,183
Gross profit	\$ 11,520	\$ 96	\$ 120	\$ 11,736
Net income (loss)	\$ 2,808	\$ (4,354)	\$ 46	\$ (1,500)
Interest expense	\$ 134	\$ 71	\$ —	\$ 205
Interest income	\$ 15	\$ 1	\$ 3	\$ 19
Depreciation and amortization	\$ 1,420	\$ 232	\$ 51	\$ 1,703
<u>Six months ended November 30, 2003</u>				
Net revenues	\$ 84,663	\$ 146	\$ 259	\$ 85,068
International sales	\$ 28,499	\$ —	\$ —	\$ 28,499
Gross profit	\$ 10,830	\$ 48	\$ 233	\$ 11,111
Net income (loss)	\$ 2,104	\$ (4,313)	\$ 2	\$ (2,207)
Interest expense	\$ 430	\$ 103	\$ —	\$ 533
Interest income	\$ 87	\$ —	\$ 4	\$ 91
Depreciation and amortization	\$ 1,431	\$ 232	\$ 90	\$ 1,753

During the six months ended November 28, 2004 and November 30, 2003, sales to the Company's top five customers accounted for approximately 45% and 43%, respectively, of revenues, with the Company's top customers from the Food Products Technology segment, Costco Wholesale Corp., accounting for approximately 14% and 11%, respectively, and Pomina Enterprise Co. LTD, accounting for approximately 10% and 7%, respectively of revenues. The Company expects that, for the foreseeable future, a limited number of customers may continue to account for a significant portion of its net revenues.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with the unaudited consolidated financial statements and accompanying notes included in Part I—Item 1 of this Form 10-Q and the audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in Landec's Annual Report on Form 10-K for the fiscal year ended May 30, 2004.

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Potential risks and uncertainties include, without limitation, those mentioned in this report and, in particular the factors described below under "Additional Factors That May Affect Future Results," and those mentioned in Landec's Annual Report on Form 10-K for the fiscal year ended May 30, 2004. Landec undertakes no obligation to update or revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this report.

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

There have been no material changes to the Company's critical accounting policies which are included and described in the Form 10-K for the fiscal year ended May 30, 2004 filed with the Securities and Exchange Commission on August 2, 2004.

### **The Company**

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

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

Landec has two core businesses – Food Products Technology and Agricultural Seed Technology, in addition to our Technology Licensing/Research and Development business which is included in Corporate and Other for segment disclosure purposes (see note 11).

Our Food Products Technology business is operated through a subsidiary, Apio, Inc., and combines our proprietary food packaging technology with the capabilities of a large national food supplier and value-added produce processor. Value-added processing incorporates Landec's proprietary packaging technology with produce that is processed by washing, and in some cases cutting and mixing, resulting in packaged produce to achieve increased shelf life and reduced shrink (waste) and to eliminate the need for ice during the distribution cycle. This combination was consummated in December 1999 when the Company acquired Apio, Inc. and certain related entities (collectively, "Apio").

Our Agricultural Seed Technology business is operated through a subsidiary, Landec Ag, Inc., (“Landec Ag”) and combines our proprietary Intellicoat® seed coating technology with our unique eDC® – e-commerce, direct marketing and consultative selling – capabilities which we obtained when we acquired Fielder’s Choice Direct (“Fielder’s Choice”), a direct marketer of hybrid seed corn, in September 1997.

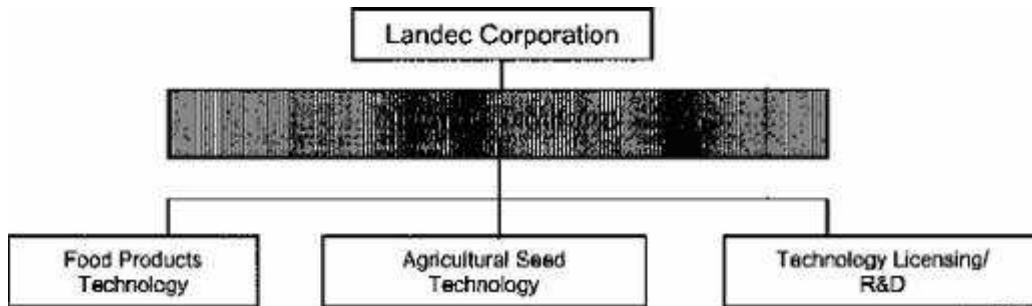
In addition to our two core businesses, the Company also operates a Technology Licensing/Research and Development business that licenses and/or supplies products outside of our core businesses to industry leaders such as Alcon Laboratories, Inc. and L’Oreal of Paris.

Landec has been unprofitable during each fiscal year since its inception, except for the fiscal year ended May 30, 2004, and the seven-month period ended May 25, 2003, and 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 Landec will remain consistently profitable. From inception through November 28, 2004, Landec’s accumulated deficit was \$56.8 million.

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

### **Description of Core Business**

Landec participates in two core business segments Food Products Technology and Agricultural Seed Technology. In addition to these two core segments, we license technology and conduct ongoing research and development through our Technology Licensing/Research and Development Business.



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

The Company began marketing in early 1996 our proprietary Intelimer-based specialty packaging for use in the fresh-cut produce market, one of the fastest growing segments in the produce industry. Our proprietary packaging technology, when combined with produce that is processed by washing, and in some cases cut and mixed, results in packaged produce with increased shelf life, reduced shrink (waste) and without the need for ice during the distribution cycle, which we refer to as our “value-added” products. In December 1999, we acquired Apio, our largest customer at that time in the Food Products Technology business and one of the nation’s leading marketers and packers of produce and specialty packaged fresh-cut vegetables. Apio provides year-round access to produce, utilizes state-of-the-art fresh-cut produce processing technology and distributes to the top U.S. retail grocery chains and major club stores and has recently begun expanding its product offerings to the foodservice industry. Our proprietary Intelimer-based packaging business has been combined with Apio into a wholly owned 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 produce market.

Based in Guadalupe, California, Apio, when acquired in December 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 packaging. Effective June 30, 2003, the Company exited the selling of domestic commodity vegetable products and sold certain assets associated with this business to Apio Fresh LLC (“Apio Fresh”). Apio Fresh is owned by a group of entities and persons that supply produce to Apio. The Apio CEO is a 12.5% owner in Apio Fresh. The fresh-cut value-added produce processing business sells a variety of fresh-cut vegetables to the top retail grocery chains representing over 11,200 retail and club stores. During the twelve months ended May 30, 2004, Apio shipped more than 17 million cartons of produce to over 700 customers including 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 the Dole® brand 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 Intelimer packaging technology. Our 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. To augment the strategy, in October 2004 Apio entered into an agreement with Caito Foods Service, Inc. of Indianapolis, Indiana, to regionally process, package and distribute Apio’s value-added specialty packaged fresh-cut vegetable tray 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 Intelimer packaging technology .
- **Expanded Product Line Using Technology:** Apio, through the use of Landec’s Intelimer packaging technology, is introducing on average twelve 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 a meal line of products. During the last twelve months, Apio has introduced twelve new products.

### *Agricultural Seed Technology Business*

Landec Ag’s strategy is build a vertically integrated seed technology company based on Intellicoat seed coating technology and its eDC — e-commerce, direct marketing and consultative selling capabilities.

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 2004 Pollinator Plus was used by over 35 seed companies on approximately 15% of the seed production acres in the U.S.

In 2003, after two years of on-farm trails, Landec Ag commercialized Early Plant® corn by selling to farmers through its Fielder's Choice Direct® brand. This application is a management tool, which 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 2004, seven seed companies offered Intellicoat on their hybrid seed corn offerings and sales increased by 50% over 2003.

The third commercial application 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 not possible. This provides significant financial benefit especially to farmers in the corn belt who grow wheat as a single crop.

Based in Monticello, Indiana, Fielder's Choice Direct offers a comprehensive line of corn hybrids and alfalfa to more than 12,000 farmers in over forty states through direct marketing programs. The success of Fielder's Choice 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, Fielder's Choice has developed a proprietary e-commerce direct marketing, and consultative selling information technology, called "eDC", 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 95,000 farmers. In August 1999, we launched the seed industry's first comprehensive e-commerce website. This website furthers our ability to provide a high level of consultation to Fielder's Choice customers, backed by a seven day a week call center capability that enables us to use the internet as a natural extension of our direct marketing strategy.

Due to the cyclical nature of the corn seed industry, a significant portion of Landec Ag revenues and profits will be concentrated over a few months during the spring planting season (generally during Landec's third and fourth fiscal quarters). In addition, Landec Ag purchases corn seed and collects cash deposits from farmers in advance of shipping the corn during the Company's third and fourth quarters.

#### ***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 release small molecule drugs, catalysts, pesticides or fragrances just by changing the temperature of the Intelimer materials or to activate adhesives through controlled temperature change. In order to exploit these opportunities, we have entered into and will enter into licensing and collaborative corporate agreements for product development and/or distribution in certain fields.

#### **Results of Operations**

**Revenues** (in thousands):

	<u>Three months ended 11/28/04</u>	<u>Three months ended 11/30/03</u>	<u>Change</u>	<u>Six months ended 11/28/04</u>	<u>Six months ended 11/30/03</u>	<u>Change</u>
<i>Apio Value Added</i>	\$ 27,983	\$ 22,829	23%	\$ 53,185	\$ 45,113	18%
<i>Apio Trading</i>	21,735	18,778	16%	42,046	34,696	21%
<i>Apio Bananas</i>	—	458	N/M	—	945	N/M
<i>Apio Service</i>	876	1,072	(18)%	2,038	3,909	(48)%
<i>Total Apio</i>	50,594	43,137	17%	97,269	84,663	15%
<i>Landec Ag</i>	7	19	(63)%	105	146	(28)%
<i>Corporate</i>	70	109	(36)%	151	259	(42)%
<i>Total Revenues</i>	50,671	43,265	17%	97,525	85,068	15%

### *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 primarily under Apio's Eat Smart brand and the Dole brand.

The increase in Apio's value-added revenues for the three and six months ended November 28, 2004 compared to the same periods 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 17% and 14%, respectively, during the three and six months ended November 28, 2004 compared to the same periods last year. In addition, sales of Apio's value-added vegetable tray products grew 95% and 97%, respectively, during the three and six months ended November 28, 2004 compared to the same periods last year. Overall value-added unit sales volume increased 20% during the second quarter of fiscal year 2005 compared to the same period last year and 15% for the six months ended November 28, 2004 compared to the same period of the prior 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 increase in revenues in Apio's trading business for the three and six months ended November 28, 2004 compared to the same periods last year was primarily due to export unit volume increases of 6% and 15%, respectively, coupled with higher sales prices.

### *Apio Bananas*

Apio banana revenues have historically consisted of revenues generated from the sale of bananas in our proprietary packaging. During fiscal year 2004, bananas were sold almost exclusively to food service companies. Beginning in fiscal year 2005, sales from the Company's banana program consist of the Company's proprietary breathable membranes.

As a result of discontinuing the sale of bananas in our proprietary packaging to focus on selling our proprietary breathable membranes for banana packaging, which is not expected to begin until our third or fourth fiscal quarter of 2005, there were no revenues in our banana program during the three and six months ended November 28, 2004 compared to \$457,000 and \$944,000 during the three and six months ended November 30, 2003, respectively. We do not expect significant revenues or gross profits from our banana program in fiscal year 2005.

### *Apio Service*

Prior to its sale on June 30, 2003, 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, a vegetable cooling operation in which Apio is the general partner with a 60% ownership position.



The decrease in service revenues during the three and six months ended November 28, 2004 compared to the same periods last year is directly attributable to the sale of Apio's domestic commodity vegetable business on June 30, 2003.

*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. Virtually all of Landec Ag's revenues are generated during the Company's third and fourth quarters.

The decrease in revenues at Landec Ag during the three and six months ended November 28, 2004 compared to the same periods last year was not material to consolidated Landec revenues.

*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 three and six months ended November 28, 2004 compared to the same periods of the prior year was not material to consolidated Landec revenues.

**Gross Profit** (in thousands):

	Three months ended 11/28/04	Three months ended 11/30/03	Change	Six months ended 11/28/04	Six months ended 11/30/03	Change
<i>Apio Value Added</i>	4,313	3,642	18%	8,358	7,826	7%
<i>Apio Trading</i>	1,098	923	19%	2,283	1,832	25%
<i>Apio Bananas</i>	—	(264)	N/M	—	(470)	N/M
<i>Apio Service</i>	454	635	(29)%	879	1642	(46)%
<i>Total Apio</i>	5,865	4,936	19%	11,520	10,830	6%
<i>Landec Ag</i>	76	7	986%	96	48	100%
<i>Corporate</i>	55	87	(37)%	120	233	(48)%
<i>Total Gross Profit</i>	5,996	5,030	19%	11,736	11,111	6%

*General*

There are numerous factors that can influence gross profits including product mix, customer mix, manufacturing costs (raw materials, such as fresh produce, corn seed, polymer materials and packaging, labor and overhead), 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 following discussion surrounding gross profits includes management's best estimates of the reasons for the changes for the three months and six months ended November 28, 2004 compared to the same periods 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 three and six months ended November 28, 2004 compared to the same periods last year was due to (1) the increase in value-added sales which increased 23% for the quarter and 18% for the first six months of fiscal year 2005, (2) product mix changes to higher margin products and (3) improved manufacturing efficiencies through further automation of Apio's production process. The increase in gross profits for the first six months of fiscal year 2005 was partially offset by inventory write-offs during the first quarter in preparation for new product introductions.

*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 three and six months ended November 28, 2004 compared to the same periods last year was primarily due to a 16% and 21% increase in trading revenues.

*Apio Service*

The decrease in Apio's service gross profits during the three and six months ended November 28, 2004 compared to the same periods last year was directly attributable to the sale of Apio's domestic commodity vegetable business on June 30, 2003.

*Apio Bananas, Landec Ag and Corporate*

The change in gross profits for Apio Bananas, Landec Ag and Corporate for the three and six months ended November 28, 2004 compared to the same periods last year was not material to consolidated Landec gross profits.

**Operating Expenses** (in thousands):

	<u>Three months ended 11/28/04</u>	<u>Three months ended 11/30/03</u>	<u>Change</u>	<u>Six months ended 11/28/04</u>	<u>Six months ended 11/30/03</u>	<u>Change</u>
<b>Research and Development:</b>						
<i>Apio</i>	255	386	(34)%	543	721	(25)%
<i>Landec Ag</i>	192	284	(32)%	418	546	(23)%
<i>Corporate</i>	238	327	(27)%	528	651	(19)%
<b>Total R&amp;D</b>	<u>685</u>	<u>997</u>	<u>(31)%</u>	<u>1,489</u>	<u>1,918</u>	<u>(22)%</u>
<b>Selling, General and Administrative:</b>						
<i>Apio</i>	3,346	2,787	20%	6,498	6,263	4%
<i>Landec Ag</i>	1,849	1,664	11%	3,369	3,071	10%
<i>Corporate</i>	751	770	(2)%	1,454	1,370	6%
<b>Total S,G&amp;A</b>	<u>5,946</u>	<u>5,221</u>	<u>14%</u>	<u>11,321</u>	<u>10,704</u>	<u>6%</u>

*Research and Development*

Landec's research and development expenses consist primarily of expenses involved in the development and process scale-up initiatives as well as legal fees associated with protecting Landec's intellectual property (patents, trademarks, etc.). Research and development efforts at Apio are focused on the Company's proprietary breathable membranes used for packaging produce, with recent focus on extending the shelf life of bananas. 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 three months and six months ended November 28, 2004 compared to the same periods last year was primarily due to lower research and development expenses associated with the Company's non-banana related programs at Apio and greater emphasis at Apio and Landec Ag on sales and marketing versus research and development.

*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 three months and six months ended November 28, 2004 compared to the same periods last year was primarily due to an increase in sales and marketing expenses at both Apio and Landec Ag in order to generate increases in revenue.

**Other** (in thousands):

	<u>Three months ended 11/28/04</u>	<u>Three months ended 11/30/03</u>	<u>Change</u>	<u>Six months ended 11/28/04</u>	<u>Six months ended 11/30/03</u>	<u>Change</u>
<i>Interest Income</i>	9	38	(76)%	19	91	(79)%
<i>Interest Expense</i>	(87)	(259)	(66)%	(205)	(533)	(62)%
<i>Other Expense</i>	(95)	(174)	(45)%	(240)	(254)	(6)%
<i>Total Other</i>	(173)	(395)	(56)%	(426)	(696)	(39)%

*Interest Income*

The decrease in interest income for the three and six month periods ended November 28, 2004 compared to the same periods last year was due to a reduction in interest bearing notes receivable at Apio.

*Interest Expense*

The decrease in interest expense during the three and six months ended November 28, 2004 compared to the same periods last year was due to the Company using cash generated from operations to pay down debt and thus lowering interest expenses.

*Other Expense*

Other consists of the minority interest expense associated with the limited partners equity interest in the net income of Apio Cooling, LP and non operating income and expenses such as the gain or loss on the sale of assets.

The change in other expense for the three and six months ended November 28, 2004 compared to the same periods last year was not material to the consolidated net loss of Landec.

**Liquidity and Capital Resources**

As of November 28, 2004, the Company had cash and cash equivalents of \$6.2 million, a net decrease of \$243,000 from \$6.5 million at May 30, 2004.

*Cash Flow from Operating Activities*

Landec used \$1.6 million of cash flow in operating activities during the six months ended November 28, 2004 compared to using \$4.8 million from operating activities for the six months ended November 30, 2003. The primary sources of cash during the six months ended November 28, 2004 were from an increase in payables of \$1.5 million due to timing of payments and from an increase in deferred revenue of \$2.4 million as a result of cash deposits for future seed corn shipments. The primary uses of cash in operating activities were from the purchase of seed corn inventory by Landec Ag of \$4.8 million and an increase in inventory at Apio of \$1.3 million primarily related to export inventory in transit.

*Cash Flow from Investing Activities*

Net cash used in investing activities for the six months ended November 28, 2004 was \$2.3 million compared to \$1.3 million for the same period last year. The primary uses of cash for investing activities during the first six months of fiscal year 2005 were for the purchase of \$2.1 million of property and equipment primarily for the further automation of Apio's value-added facility.

### *Cash Flow from Financing Activities*

Net cash provided by financing activities for the six months ended November 28, 2004 was \$3.7 compared to net cash provided by financing activities of \$4.8 million for the same period last year. The cash provided by financing activities during the first six months of fiscal year 2005 was primarily from the sale of \$4.4 million of Landec Common Stock, of which \$3.5 million was sold to Chiquita and the remainder was from the exercise of stock options.

### *Capital Expenditures*

During the six months ended November 28, 2004, Landec purchased vegetable processing equipment to support the expansion of Apio's value added business. These expenditures represented the majority of the \$2.1 million of equipment purchased.

### *Debt*

In August 2003, Apio entered into a \$12 million working capital line and a \$3 million equipment line (the "Lines") with Wells Fargo Business Credit, Inc. The term of the Lines was three years expiring on July 31, 2006. Concurrently with entering into the new revolving line of credit on September 1, 2004 with Wells Fargo Bank N.A., the Company paid off and terminated its Lines with Wells Fargo Business Credit, Inc.

On September 1, 2004, Apio entered into 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 prior equipment line of credit (collectively the "Loan Agreement") with Wells Fargo Bank N.A. Outstanding amounts under the Loan Agreement bear interest at either the prime rate or the LIBOR adjustable rate plus 2.25% (4.21% at November 28, 2004). The Loan Agreement contains certain restrictive covenants, which requires Apio to meet certain financial tests including, minimum levels of net income, maximum leverage ratio, minimum net worth and maximum capital expenditures. The Loan Agreement also affects the ability of Landec to receive payments on debt owed by Apio to Landec. Landec has pledged substantially all of the assets of Apio to secure the lines with Wells Fargo Bank. Concurrently with entering into this agreement with Wells Fargo Bank, the Company paid off and terminated its lines of credit with Wells Fargo Business Credit, Inc. At November 28, 2004, 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 plus 0.375%. 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 has pledged substantially all of the assets of Landec Ag to secure the line of credit. At November 28, 2004, \$4.2 million was outstanding under Landec Ag's revolving line of credit.

At November 28, 2004, Landec's total debt, including current maturities, was \$8.8 million and the total debt to equity ratio was 14% compared to 15% at May 30, 2004. Of this debt, approximately \$4.2 million was comprised of revolving lines of credit and approximately \$4.6 million was comprised of term debt, \$2.2 million of which is mortgage debt on Apio's manufacturing facilities. The amount of debt outstanding on Landec'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. In addition, in connection with Landec's acquisition of Apio, Landec has remaining obligations to pay the former owners of Apio \$1.2 million (recorded at \$1.1 million on a discounted basis). The \$1.2 million will be paid during the third quarter of fiscal year 2005 and is recorded as current portion of long-term debt.

### Contractual Obligation

The Company's material contractual obligations for the next five years and thereafter as of November 28, 2004, are as follows (in thousands):

Obligation	Due in Fiscal Year Ended May						Thereafter
	Total	Remainder of 2005	2006	2007	2008	2009	
Lines of Credit	\$ 4,192	\$ 4,192	\$ —	\$ —	\$ —	\$ —	\$ —
Long-term Debt	4,599	1,510	558	551	292	144	1,544
Operating Leases	1,921	335	622	459	331	174	—
Land Leases	1,248	31	68	68	68	68	945
Licensing Obligation	750	50	100	100	100	100	300
Purchase Commitments	422	422	—	—	—	—	—
Total	<u>\$ 13,132</u>	<u>\$ 6,540</u>	<u>\$ 1,348</u>	<u>\$ 1,178</u>	<u>\$ 791</u>	<u>\$ 486</u>	<u>\$ 2,789</u>

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

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

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

### ***We Have a History of Losses Which May Continue***

We have incurred net losses in each fiscal year since our inception, except for the fiscal year ended May 30, 2004 and the seven-month period ended May 25, 2003. Our accumulated deficit as of November 28, 2004 totaled \$56.8 million. We 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.

### ***Our Indebtedness Could Limit Our Financial and Operating Flexibility***

At November 28, 2004, our total debt, including current maturities, was \$8.8 million and the total debt to equity ratio was 14%. Of this debt, \$4.2 million is comprised of revolving lines of credit and \$4.6 million is comprised of term debt. On September 1, 2004, Apio entered into a new \$10 million revolving line of credit, a 12-month, \$4.8 million equipment line of credit, and a 36-month, \$1.2 million term note for equipment purchased under the prior equipment line of credit with Wells Fargo Bank N.A. The amount of debt outstanding under the Apio and Landec Ag lines of credit fluctuate over time, and the agreements contain restrictive covenants that require each company to meet certain financial tests including minimum levels of net income, maximum leverage ratio, minimum net worth and maximum capital expenditures. The lines of credit limit the ability of Apio and Landec Ag to make cash payments to Landec if certain conditions, as defined in the agreements, are not met. Landec has pledged substantially all of the assets of Apio and Landec Ag to secure their bank debt. Of our non-revolving debt, \$1.5 million, \$558,000 and \$551,000 become due over the next three fiscal years, respectively. This level of indebtedness limits our financial and operating flexibility in the following ways:

- a portion of net cash flow from operations must be dedicated to debt service and will not be available for other purposes;
- our ability to obtain additional debt financing in the future for working capital is reduced;
- our ability to fund capital expenditures or acquisitions may be limited; and
- our ability to react to changes in the industry and economic conditions generally may be limited.

In connection with the Apio acquisition, we may be obligated to make future payments to the former shareholders of Apio of up to \$1.2 million for the future supply of produce. This amount is scheduled to be paid during the third quarter of fiscal year 2005.

Our ability to service this indebtedness and these future payments will depend on our future performance, which will be affected by prevailing economic conditions and financial, business and other factors, some of which are beyond our control. If we are unable to service this debt, we would be forced to pursue one or more alternative strategies such as selling assets, restructuring or refinancing our indebtedness or seeking additional equity capital, which might not be successful and which could substantially dilute the ownership interest of existing shareholders.

### ***We Have Violated Restrictions in Our Loan Agreements and May Have to Pursue New Financings if We Are Unable to Comply with These Provisions in the Future***

Apio is subject to various financial and operating covenants under the Well Fargo Bank lines of credit, including minimum fixed charge coverage ratio, minimum adjusted net worth and minimum net income. The Wells

Fargo Bank agreement limits the ability of Apio to make cash payments to Landec. On April 27, 2003, Apio was in technical violation of the minimum net worth covenant under a previous line of credit with Bank of America, which violation was subsequently waived by Bank of America. If we violate any obligations under the lines of credit in the future, we could trigger an event of default, which, if not cured or waived, would permit acceleration of our obligation to repay the indebtedness due under our lines. If the indebtedness due under the lines were accelerated, we would be forced to pursue one or more alternative strategies such as selling assets, seeking new debt financing from another lender or seeking additional equity capital, which might not be achievable or available on attractive terms, if at all, and which could substantially dilute the ownership interest of existing shareholders.

***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 and January 2004 due to a shortage of essential value-added produce items which had to be purchased at inflated prices on the open market. Our earnings may also fluctuate based on our ability to collect accounts receivables from customers and note receivables from growers. Our earnings from our Food Products Technology business are sensitive to price fluctuations in the fresh vegetables and fruits markets. Excess supplies can cause intense price competition. Other factors that affect our food and/or agricultural operations include:

- the seasonality of our supplies;
- our ability to process produce during critical harvest periods;
- the timing and effects of ripening;
- the degree of perishability;
- the effectiveness of worldwide distribution systems;
- total worldwide industry volumes;
- the seasonality of consumer demand;
- foreign currency fluctuations; and
- foreign importation restrictions and foreign political risks.

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



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

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

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

We may not be able to develop and introduce new products and technologies in a timely manner or new products and technologies may not gain market acceptance. We are in the early stage of product commercialization of certain Intelimer-based specialty packaging, Intelicoat seed coating 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 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, virtually all 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 FDC Act. Under the FDC Act, any substance that when used as intended may reasonably be expected to become, directly or indirectly, a component or otherwise affect the characteristics of any food may be regulated as a food additive unless the substance is generally recognized as safe. We believe that food packaging materials are generally not considered food additives by the FDA because these products are not expected to become components of food under their expected conditions of use. We consider our breathable membrane product to be a food packaging material not subject to regulation or approval by the FDA. We have not received any communication from the FDA concerning our breathable membrane product. If the FDA were to determine that our breathable membrane products are food additives, we may be required to submit a food additive petition for approval by the FDA. The food additive petition process is lengthy, expensive and uncertain. A determination by the FDA that a food additive petition is necessary would have a material adverse effect on our business, operating results and financial condition.

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

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

The Company is subject to the Perishable Agricultural Commodities Act (“PACA”) law. PACA regulates fair trade standards in the fresh produce industry and governs all the product 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 affect 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. In addition, we may not receive any royalties on future sales of QuickCast™ and PORT™ products because we no longer have control over the sales of those products. Our partners may pursue existing or alternative technologies in preference to our technology. Furthermore, we may not be able to negotiate additional collaborative arrangements in the future on acceptable terms, if at all, and our collaborative arrangements may not be successful.

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

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

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

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

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

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

For the six months ended November 28, 2004, approximately 37% of our total revenues were derived from product sales to international customers. A number of risks are inherent in international transactions. International sales and operations may be limited or disrupted by any of the following:

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

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

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

During the six months ended November 28, 2004, sales to our top five customers accounted for approximately 45% of our revenues, with our largest customers, Costco Wholesale Corp. and Pomina Enterprise Co. LTD, accounting for approximately 14% and 10% of our revenues, respectively. 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 Apio and Landec Ag 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 often 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 involves 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 with limits in the amount of \$41.0 million per occurrence and \$42.0 million in the annual aggregate. 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***

Over the past several years the stock market has experienced extreme price and volume fluctuations. 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 currently 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 Are Likely to Increase Our Costs***

The Sarbanes-Oxley Act of 2002 (the “Act”) that became law in July 2002 requires 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. We expect these developments to increase our legal and financial compliance costs. We expect these changes to 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. We are presently evaluating and monitoring regulatory developments and cannot estimate the timing or magnitude of additional costs we may incur as a result of the Act.

#### ***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.

#### ***Terrorist Attacks and Risk of Contamination May Negatively Impact All Aspects of Our Operations, Revenues, Costs and Stock Price***

The September 2001 terrorist attacks in the United States, as well as future events occurring in response or connection to them, including, future terrorist attacks against United States targets, rumors or threats of war, actual conflicts involving the United States or its allies, or trade disruptions impacting our domestic suppliers or our customers, may impact our operations and may, among other things, cause decreased sales of our products. More generally, these events have affected, and are expected to continue to affect, the general economy and customer demand for our products. While we do not believe that our employees, facilities, or products are a target for terrorists, there is a remote risk that terrorist activities could result in contamination or adulteration of our products. Although we have systems and procedures in place that are designed to prevent contamination and adulteration of our products, a disgruntled employee or third party could introduce an infectious substance into packages of our products, either at our manufacturing plants or during shipment of our products. Were our products to be tampered with, we could experience a material adverse effect in our business, operations and financial condition.

#### ***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 line 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.

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

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

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

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 November 28, 2004.

	<u>Remainder of</u> <u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>There-</u> <u>after</u>	<u>Total</u>
<b>Liabilities (in 000's)</b>							
Lines of Credit	\$ 4,192	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 4,192
Avg. Int. Rate	5.22%						5.22%
Long term debt, including current portion							
Fixed Rate	\$ 1,510	\$ 558	\$ 551	\$ 292	\$ 144	\$ 1,544	\$ 4,599
Avg. Int. Rate	6.59%	4.73%	4.54%	4.34%	4.24%	4.29%	5.62%

**Item 4. Controls and Procedures**

- (a) Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q (the "Evaluation Date"), Landec's principal executive officer and principal financial officer concluded that, as of the Evaluation Date, Landec's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), were effective such that the material information required to be disclosed by Landec in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.
- (b) Since the Evaluation Date, there have not been any significant changes in Landec's internal controls or in other factors that could significantly affect these controls, including any corrective actions with regard to significant deficiencies and material weaknesses.



## PART II . OTHER INFORMATION

### Item 1. Legal Proceedings

None.

### Item 2. Changes in Securities and Use of Proceeds

Pursuant to a Stock Purchase Agreement dated September 3, 2004, the Company and Chiquita Brands International, Inc. on October 14, 2004, completed a financing pursuant to which the Company raised net proceeds of approximately \$3.5 million in a private placement of 486,111 shares of Common Stock at a price of \$7.20 per share (the "Financing"). The Company intends to use the proceeds for working capital purposes.

The issuance of securities in this Item 2 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 recipient of the securities in such transaction represented its 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 that it 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 recipient was given adequate access to information about the Company.

### Item 3. Defaults Upon Senior Securities

None.

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

At the Company's Annual Meeting of Shareholders held on September 30, 2004 the following proposals were adopted by the margins indicated:

	Number of Shares	
	Voted For	Withheld
1. Four Class 1 directors were elected by the margins indicated to serve for a term of office to expire at the second succeeding annual meeting of shareholders at which their successors will be elected and qualified:		
Frederick Frank	16,494,223	260,518
Stephen E. Halprin	16,452,562	302,179
Richard S. Schneider, Ph.D.	16,480,648	274,093
Kenneth E. Jones	16,518,648	236,093
The Class II directors were not up for election at the Annual Meeting. The five current Class II directors, Gary T. Steele, Kirby L. Cramer, Duke Bristow, Robert Tobin and Nicholas Tompkins will serve as Class II directors until the next Annual Meeting, when their successors will be elected and qualified.		

	<u>Voted For</u>	<u>Voted Against</u>	<u>Abstain</u>
2. To ratify the appointment of Ernst & Young LLP as independent public accountants of the Company for the 2005 fiscal year.	16,549,456	184,650	20,635

**Item 5. Other Information**

None.

**Item 6. Exhibits**

<u>Exhibit Number</u>	<u>Exhibit Title:</u>
10.1+	Bonus Incentive Plan for Fiscal Year 2005
31.1+	CEO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
31.2+	CFO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
32.1+	CEO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
32.2+	CFO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

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+ Filed herewith.

## SIGNATURES

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

LANDEC CORPORATION

By: /s/ Gregory S. Skinner  
Gregory S. Skinner

Vice President, Finance and Chief Financial Officer  
(Principal Financial and Accounting Officer)

Date: January 7, 2005

**Bonus Incentive Plan for Fiscal Year 2005**

Under the Bonus Incentive Plan for Fiscal Year 2005 (the "Plan") employees of Landec Corporation (the "Company") and its subsidiaries may earn cash bonuses for fiscal year 2005 based upon the achievement of specified annual performance goals and objectives relating to the Company and its subsidiaries, including goals based on the Company's stock price and earnings per share, and controllable income of the Company's subsidiaries and the status of certain regulatory submissions. Bonuses are calculated by multiplying a percentage of each participant's base salary by the percentage of the aggregate performance goals that is attained. The percentage of base salary used to determine each participant's cash bonus payment ranges from 5% to 100% of base salary. 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.

Pursuant to his employment agreement and based upon the attainment of specified annual performance goals and objectives of the Company for fiscal year 2005, Gary Steele, the Company's Chief Executive Officer, has the opportunity to earn a bonus stock option award to purchase shares of the Company's common stock, in addition to the opportunity to earn a cash bonus based on a percentage of base salary. Mr. Steele's cash bonus and bonus stock option award will be based upon certain annual performance goals tied to the Company's stock price, earnings per share and completion of certain business transactions. Mr. Steele's cash bonus and bonus stock option award will be determined based on the percentage of the aggregate performance goals that is attained. The bonus stock option award will have an exercise price equal to the fair market value of the Company's common stock on the date of grant.

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## CERTIFICATIONS

I, Gary T. Steele, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Landec Corporation;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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)) 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 quarterly report is being prepared;
  - (b) (paragraph intentionally omitted pursuant to SEC Release 33-8238);
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation, and
  - (d) disclosed in this quarterly 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 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 officers 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 registrant's board of directors (or persons performing the equivalent functions):
  - (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: January 7, 2005

/s/ Gary T. Steele

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Gary T. Steele

President and Chief Executive Officer

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## CERTIFICATIONS

I, Gregory S. Skinner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Landec Corporation;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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)) 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 quarterly report is being prepared;
  - (b) (paragraph intentionally omitted pursuant to SEC Release 33-8238);
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - (d) disclosed in this quarterly 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 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 officers 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 registrant's board of directors (or persons performing the equivalent functions):
  - (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: January 7, 2005

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

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

In connection with the Quarterly Report of Landec Corporation (the "Company") on Form 10-Q for the period ending November 28, 2004 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: January 7, 2005

/s/ Gary T. Steele

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-Q or as a separate disclosure document.

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

In connection with the Quarterly Report of Landec Corporation (the "Company") on Form 10-Q for the period ending November 28, 2004 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: January 7, 2005

/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-Q or as a separate disclosure document.

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