

LANDEC CORP \CA\

FORM 10-Q (Quarterly Report)

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Address 3603 HAVEN AVE
MENLO PARK, CA 94025
Telephone 6503061650
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Fiscal Quarter Ended November 28, 2010, 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)

Delaware

(State or other jurisdiction of
incorporation or organization)

94-3025618

(IRS Employer
Identification Number)

3603 Haven Avenue

Menlo Park, California 94025

(Address of principal executive offices)

Registrant's telephone number, including area code:

(650) 306-1650

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 has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large Accelerated Filer

Accelerated Filer

Non Accelerated Filer

Smaller Reporting Company

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

Yes No

As of December 21, 2010, there were 26,591,582 shares of Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

| | November 28, 2010 | May 30, 2010 |
|--|----------------------|-------------------|
| | <u>(Unaudited)</u> | <u>(1)</u> |
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 5,447 | \$ 27,817 |
| Marketable securities | 39,593 | 20,421 |
| Accounts receivable, less allowance for doubtful accounts of \$250 and \$189 at November 28, 2010 and May 30, 2010, respectively | 24,670 | 18,637 |
| Accounts receivable, related party | 461 | 729 |
| Income taxes receivable | 642 | 739 |
| Inventories, net | 19,744 | 16,107 |
| Notes and advances receivable | 1,169 | 241 |
| Deferred taxes | 1,363 | 1,262 |
| Prepaid expenses and other current assets | 1,459 | 2,989 |
| Total Current Assets | <u>94,548</u> | <u>88,942</u> |
| Property, plant and equipment, net | 51,130 | 50,161 |
| Goodwill, net | 41,189 | 41,154 |
| Trademarks/tradenames, net | 12,428 | 12,428 |
| Customer relationships, net | 3,519 | 3,674 |
| Other assets | 4,214 | 3,838 |
| Total Assets | <u>\$ 207,028</u> | <u>\$ 200,197</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 18,928 | \$ 14,354 |
| Related party accounts payable | 122 | 349 |
| Accrued compensation | 2,147 | 2,043 |
| Other accrued liabilities | 2,909 | 3,277 |
| Deferred revenue | 2,241 | 3,391 |
| Current portion of long-term debt | 4,329 | 4,521 |
| Total Current Liabilities | <u>30,676</u> | <u>27,935</u> |
| Long-term debt | 17,501 | 19,249 |
| Deferred revenue | — | 1,000 |
| Deferred taxes | 9,639 | 8,801 |
| Other non-current liabilities | 11,240 | 10,737 |
| Total Liabilities | <u>69,056</u> | <u>67,722</u> |
| Stockholders' Equity: | | |
| Common stock, \$0.001 par value; 50,000,000 shares authorized; 26,329,841 and 26,490,259 shares issued and outstanding at November 28, 2010 and May 30, 2010, respectively | 27 | 27 |
| Additional paid-in capital | 119,154 | 117,730 |
| Accumulated other comprehensive loss | (331) | (179) |
| Retained earnings | 17,565 | 13,206 |
| Total Stockholders' Equity | <u>136,415</u> | <u>130,784</u> |
| Noncontrolling interest | 1,557 | 1,691 |
| Total Equity | <u>137,972</u> | <u>132,475</u> |
| Total Liabilities and Stockholders' Equity | <u>\$ 207,028</u> | <u>\$ 200,197</u> |

(1) Derived from audited financial statements.

See accompanying notes.

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

| | Three Months Ended | | Six Months Ended | |
|--|----------------------|----------------------|----------------------|----------------------|
| | November 28, 2010 | November 29, 2009 | November 28, 2010 | November 29, 2009 |
| Revenues: | | | | |
| Product sales | \$ 67,720 | \$ 58,490 | \$ 129,980 | \$ 116,882 |
| Services revenue, related party | 986 | 914 | 2,051 | 2,080 |
| License fees | 1,350 | 1,350 | 2,700 | 2,700 |
| Research, development and royalty revenues | 112 | 179 | 389 | 213 |
| Total revenues | 70,168 | 60,933 | 135,120 | 121,875 |
| Cost of revenue: | | | | |
| Cost of product sales | 56,478 | 52,009 | 107,202 | 102,115 |
| Cost of product sales, related party | 960 | 755 | 2,522 | 1,820 |
| Cost of services revenue | 875 | 752 | 1,725 | 1,653 |
| Total cost of revenue | 58,313 | 53,516 | 111,449 | 105,588 |
| Gross profit | 11,855 | 7,417 | 23,671 | 16,287 |
| Operating costs and expenses: | | | | |
| Research and development | 2,255 | 942 | 4,487 | 1,881 |
| Selling, general and administrative | 6,072 | 4,182 | 11,725 | 8,752 |
| Total operating costs and expenses | 8,327 | 5,124 | 16,212 | 10,633 |
| Operating income | 3,528 | 2,293 | 7,459 | 5,654 |
| Interest income | 117 | 266 | 224 | 554 |
| Interest expense | (209) | (4) | (435) | (5) |
| Other expense | (44) | — | (102) | — |
| Net income before taxes | 3,392 | 2,555 | 7,146 | 6,203 |
| Income tax expense | (1,209) | (895) | (2,561) | (2,176) |
| Consolidated net income | 2,183 | 1,660 | 4,585 | 4,027 |
| Noncontrolling interest | (128) | (126) | (226) | (309) |
| Net income available to common stockholders | \$ 2,055 | \$ 1,534 | \$ 4,359 | \$ 3,718 |
| Basic net income per share | \$ 0.08 | \$ 0.06 | \$ 0.17 | \$ 0.14 |
| Diluted net income per share | \$ 0.08 | \$ 0.06 | \$ 0.16 | \$ 0.14 |
| Shares used in per share computation: | | | | |
| Basic | 26,324 | 26,360 | 26,412 | 26,355 |
| Diluted | 26,560 | 26,676 | 26,639 | 26,670 |

See accompanying notes.

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

| | Six Months Ended | |
|--|----------------------|----------------------|
| | November 28, 2010 | November 29, 2009 |
| Cash flows from operating activities: | | |
| Net income applicable to Common Stockholders | \$ 4,359 | \$ 3,718 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,602 | 1,541 |
| Stock-based compensation expense | 962 | 412 |
| Tax benefit from stock-based compensation expense | (1,585) | (1,341) |
| Increase in long-term receivable | (400) | (400) |
| Noncontrolling interest | 227 | 309 |
| Deferred taxes | 737 | 474 |
| Changes in current assets and current liabilities: | | |
| Accounts receivable, net | (6,033) | (1,409) |
| Accounts receivable, related party | 268 | 264 |
| Income taxes receivable | 1,682 | — |
| Inventories, net | (3,637) | (953) |
| Issuance of notes and advances receivable | (1,565) | (1,363) |
| Collection of notes and advances receivable | 637 | 333 |
| Prepaid expenses and other current assets | 1,530 | 364 |
| Accounts payable | 4,574 | 3,310 |
| Related party accounts payable | (227) | (230) |
| Income taxes payable | — | 1,421 |
| Accrued compensation | 104 | (52) |
| Other accrued liabilities | (17) | 230 |
| Deferred revenue | (2,150) | (2,420) |
| Net cash provided by operating activities | 2,068 | 4,208 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (3,450) | (3,159) |
| Purchase of marketable securities | (41,784) | (60,495) |
| Proceeds from maturities and sales of marketable securities | 22,612 | 17,234 |
| Net cash used in investing activities | (22,622) | (46,420) |
| Cash flows from financing activities: | | |
| Repurchase of outstanding common stock | (1,184) | — |
| Taxes paid by Company for stock swaps to cover taxes on RSUs | (49) | (53) |
| Proceeds from sale of common stock | 109 | 17 |
| Tax benefit from stock-based compensation | 1,585 | 1,341 |
| Payments on long-term debt | (1,940) | — |
| Decrease in other assets | 24 | — |
| Payments to minority interest holders | (361) | (330) |
| Net cash (used in) provided by financing activities | (1,816) | 975 |
| Net decrease in cash and cash equivalents | (22,370) | (41,237) |
| Cash and cash equivalents at beginning of period | 27,817 | 43,459 |
| Cash and cash equivalents at end of period | \$ 5,447 | \$ 2,222 |
| Supplemental schedule of noncash operating activities: | | |
| Income tax expense not payable | \$ 1,585 | \$ 1,341 |
| Long-term receivable from Monsanto for guaranteed termination fee | \$ 400 | \$ 400 |
| Unrealized loss from interest rate swap | \$ 152 | \$ — |

See accompanying notes .

LANDEC CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

Organization

Landec Corporation and its subsidiaries ("Landec" or the "Company") design, develop, manufacture and sell polymer products for food and agricultural products, medical devices and licensed partner applications that incorporate Landec's patented polymer technologies. The Company has two proprietary polymer technology platforms: 1) Intelimer® polymers, and 2) hyaluronan ("HA") biopolymers. The Company's proprietary polymer technologies are the foundation, and a key differentiating advantage, upon which Landec has built its business. The Company sells specialty packaged fresh-cut vegetables and whole produce to retailers and club stores, primarily in the United States and Asia through its Apio, Inc. ("Apio") subsidiary, Hyaluronan-based biomaterials through its Lifecore Biomedical, Inc. ("Lifecore") subsidiary, and Intellicoat® coated seed products through its Landec Ag LLC ("Landec Ag") subsidiary.

Basis of Presentation

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, 2010 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, 2010.

The results of operations for the six months ended November 28, 2010 are not necessarily indicative of the results that may be expected for an entire fiscal year due to some seasonality in Apio's food business, particularly, Apio's Export business.

Basis of Consolidation

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

The Company follows accounting guidance which addresses the consolidation of variable interest entities ("VIEs"). Under the accounting guidance, arrangements that are not controlled through voting or similar rights are accounted for as VIEs. An enterprise is required to consolidate a VIE if it is the primary beneficiary of the VIE.

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

Use of Estimates

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

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

Cash, Cash Equivalents and Marketable Securities

The Company records all highly liquid securities with three months or less from date of purchase to maturity as cash equivalents. These securities consist mainly of certificate of deposits (CDs), money market funds and U.S. Treasuries. Short-term marketable securities consist of CDs that are FDIC insured and single A or better rated municipal bonds with original maturities of more than three months at the date of purchase regardless of the maturity date as the Company views its portfolio as available for use in its current operations. The aggregate amount of CDs included in marketable securities at November 28, 2010 and May 30, 2010 was \$755,000 and \$1.5 million, respectively. The Company classifies all debt securities with readily determined market values as "available for sale". The contractual maturities of the Company's marketable securities that are due in less than one year represent \$28.8 million of its marketable securities and those due in one to two years represent the remaining \$10.8 million of the Company's marketable securities as of November 28, 2010. These investments are classified as marketable securities on the consolidated balance sheet as of November 28, 2010 and May 30, 2010 and are carried at fair market value. Unrealized gains and losses are reported as a component of stockholders' equity. The cost of debt securities is adjusted for amortization of premiums and discounts to maturity. This amortization is recorded to interest income. Realized gains and losses on the sale of available-for-sale securities are also recorded to interest income and were not significant for the three and six months ended November 28, 2010 and November 29, 2009. During the three and six months ended November 28, 2010, the Company received proceeds of \$5.0 million and \$9.9 million, respectively, from the sale of marketable securities. The cost of securities sold is based on the specific identification method.

Financial Instruments

The Company's financial instruments are primarily composed of marketable debt securities, commercial-term trade payables, grower advances, and notes receivable, as well as long-term notes receivables and debt instruments. For short-term instruments, the historical carrying amount is a reasonable estimate of fair value. Fair values for long-term financial instruments not readily marketable are estimated based upon discounted future cash flows at prevailing market interest rates. Based on these assumptions, management believes the fair market values of the Company's financial instruments are not materially different from their recorded amounts as of November 28, 2010.

Investment in Non-Public Company

The Company's investment in Aesthetic Sciences Corporation ("Aesthetic Sciences"), a medical device company, is carried at cost and adjusted for impairment losses. Since there is no readily available market value information, the Company periodically reviews this investment to determine if any other than temporary declines in value have occurred based on the financial stability and viability of Aesthetic Sciences. Aesthetic Sciences sold the rights to its Smartfil™ Injector System on July 16, 2010. Landec has evaluated its cost method investment for impairment, using a discounted cash flow analysis which included the terms of the purchase agreement. Based on the terms of the agreement, the Company had determined that its investment in Aesthetic Sciences was other than temporarily impaired and therefore recorded an impairment loss of \$1.0 million as of May 30, 2010. The Company's carrying value of its investment in Aesthetic Sciences of \$792,000 at November 28, 2010 is reported as a component of other non current assets.

Fair Value Measurements

The Company adopted fair value measurement accounting guidance on May 26, 2008 for financial assets and liabilities and for financial instruments and certain other items at fair value. The Company did not elect the fair value option for any of its eligible financial assets or liabilities.

The accounting guidance established a three-tier hierarchy for fair value measurements, which prioritizes the inputs used in measuring fair value as follows:

Level 1– observable inputs such as quoted prices for identical instruments in active markets.

Level 2– inputs other than quoted prices in active markets that are observable either directly or indirectly through corroboration with observable market data.

Level 3– unobservable inputs in which there is little or no market data, which would require the Company to develop its own assumptions.

As of November 28, 2010, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company's cash equivalents and marketable securities for which the fair value is determined based on observable inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized its cash equivalents and marketable securities as Level 1. As of November 28, 2010, the Company recorded to Other Comprehensive Loss on the Consolidated Balance Sheets an unrealized loss of \$331,000, net of taxes of \$210,000, as a result of an interest rate swap agreement entered into during fiscal year 2010. The unrealized loss was based on a Level 2 hierarchy for fair value measurements. If the interest rate swap is terminated or the debt borrowed is paid off prior to April 30, 2015, the amount of unrealized loss or gain included in Other Comprehensive Income (Loss) would be reclassified to earnings. The Company has no intentions of terminating the interest rate swap or prepaying the debt in the next twelve months. The interest rate swap liability is included in other non-current liabilities as of November 28, 2010 and May 30, 2010. The Company has no other financial assets or liabilities for which fair value measurement has been adopted.

New Accounting Pronouncements

Recently Adopted Pronouncements

Variable Interest Entities

In June 2009, the FASB issued new guidance which amends the evaluation criteria to identify the primary beneficiary of a VIE. Additionally, the new guidance requires ongoing reassessments of whether an enterprise is the primary beneficiary of the VIE. The Company adopted the new guidance on May 31, 2010 and such adoption did not have an impact on the Company's results of operations or financial position for the three and six months ended November 28, 2010.

Revenue Recognition

In October 2009, the FASB issued new guidance in relation to "Multiple-Deliverable Revenue Arrangements". The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. The Company early adopted these standards as of May 31, 2010. There have been no materially modified agreements since the adoption of the standard. The adoption did not have an impact on the Company's results of operations or financial position for the three and six months ended November 28, 2010.

2. Acquisition of Lifecore Biomedical, Inc.

On April 30, 2010 (the "Acquisition Date"), the Company acquired all of the common stock of Lifecore Biomedical, Inc. ("Lifecore") under a Stock Purchase Agreement ("Purchase Agreement") in order to expand its product offerings and enter into new markets. Located in Chaska, Minnesota, Lifecore was a privately-held hyaluronan-based biomaterials company located in Chaska, Minnesota. Lifecore is principally involved in the development and manufacture of products utilizing hyaluronan, a naturally occurring polysaccharide that is widely distributed in the extracellular matrix of connective tissues in both animals and humans. In addition, Lifecore has licensed a sodium hyaluronate cross-linking technology from The Cleveland Clinic Foundation designed to provide a development vehicle for a product platform to introduce new products for the existing medical segments, as well as potentially new market segments. Furthermore, Lifecore is pursuing other development activities to utilize its fermentation and aseptic filling capabilities for non-hyaluronan based products.

Under the Purchase Agreement, the aggregate consideration payable by the Company to the former Lifecore stockholder at closing consisted of \$40.0 million in cash, which included \$6.6 million that is held in an escrow account to secure the indemnification rights of Landec and other indemnities with respect to certain matters, including breaches of representations, warranties and covenants included in the Purchase Agreement. The escrow account is in the name of the seller and Landec's right under the escrow agreement consist solely of its ability to file a claim against the escrow . In addition, the Company may be required to pay in cash up to an additional \$10.0 million in earnout payments in the event that Lifecore achieves certain revenue targets in calendar years 2011 and 2012.

The acquisition date fair value of the total consideration transferred was \$49.65 million, which consisted of the following (in thousands):

| | |
|--------------------------|------------------|
| Cash | \$ 40,000 |
| Contingent consideration | 9,650 |
| Total | <u>\$ 49,650</u> |

The assets and liabilities of Lifecore were recorded at their respective estimated fair values as of the date of the acquisition using generally accepted accounting principles for business combinations. The excess of the purchase price over the fair value of the net identifiable assets acquired has been allocated to goodwill. Goodwill represents a substantial portion of the acquisition proceeds because the Lifecore trade name provides the Company with entry into the growing, higher margin hyaluronan product market. Management believes that there is further growth potential by extending Lifecore's product lines into new channels.

The following table summarizes the estimated fair values of Lifecore's assets acquired and liabilities assumed and related deferred income taxes, effective April 30, 2010, the date the Company obtained control of Lifecore (in thousands).

| | |
|--|------------------|
| Cash and cash equivalents | \$ 318 |
| Accounts receivable, net | 1,860 |
| Inventories, net | 9,009 |
| Property and equipment | 25,529 |
| Other tangible assets | 1,455 |
| Intangible assets | 7,900 |
| Total identifiable assets acquired | <u>46,071</u> |
| Accounts payable and other liabilities | (2,983) |
| Long-term debt | (4,157) |
| Deferred taxes | (3,109) |
| Total liabilities assumed | <u>(10,249)</u> |
| Net identifiable assets acquired | 35,822 |
| Goodwill | 13,828 |
| Net assets acquired | <u>\$ 49,650</u> |

The Company used a combination of the market and cost approaches to estimate the fair values of the Lifecore assets acquired and liabilities assumed.

Inventory

A step-up in the value of inventory of \$523,000 was recorded in the allocation of the purchase price based on valuation estimates. During the three and six months ended November 28, 2010, \$132,000 and \$294,000, respectively, of this step-up was charged to cost of products sold as the inventory was sold. As of November 28, 2010, \$137,000 of the step-up remained in inventory.

Intangible Assets

The Company identified two intangible assets in connection with the Lifecore acquisition: trade names valued at \$4.2 million, which is considered to be an indefinite life asset and therefore will not be amortized; and customer base valued at \$3.7 million with a twelve year useful life. The trade name intangible asset was valued using the relief from royalty valuation method and the customer relationship intangible asset was valued using the multi-period excess earnings method.

Goodwill

The excess of the consideration transferred over the fair values assigned to the assets acquired and liabilities assumed was \$13.8 million, which represents the goodwill amount resulting from the acquisition which can be attributable to its long history and future prospects. None of the goodwill is expected to be deductible for income tax purposes. The Company will test goodwill for impairment on an annual basis or sooner, if deemed necessary. As of November 28, 2010, there were no changes in the recognized amount of goodwill resulting from the acquisition of Lifecore.

Liability for Contingent Consideration

In addition to the cash consideration paid to the former shareholder of Lifecore, the Company may be required to pay up to an additional \$10.0 million in earnout payments based on Lifecore achieving certain revenue targets in calendar years 2011 and 2012. The fair value of the liability for the contingent consideration recognized on the acquisition date was \$9.75 million and \$9.65 million, as of November 28, 2010 and May 30, 2010, respectively, and is classified as a non current liability in the Consolidated Balance Sheets. The Company determined the fair value of the liability for the contingent consideration based on a probability-weighted discounted cash flow analysis. This fair value measurement is based on significant inputs not observed in the market and thus represents a Level 3 measurement. The Company projects that it will pay the entire \$10 million earn out during the third quarter of fiscal year 2012.

3. License Agreement with Monsanto Company

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

On December 1, 2006, Landec also entered into a five-year co-exclusive technology license and polymer supply agreement ("the Monsanto Agreement") with Monsanto for the use of Landec's Intellicoat polymer seed coating technology. Under the terms of the Monsanto Agreement, Monsanto agreed to pay Landec Ag \$2.6 million per year. The Monsanto Agreement was amended in November 2009. Under the terms of the amended Monsanto Agreement, Monsanto continues to have an exclusive license to use Landec's Intellicoat polymer technology for specific seed treatment applications. Over the remaining two-year term of the amended Monsanto Agreement, Monsanto will investigate uses of Landec's Intellicoat technology in a variety of seed categories in the field exclusively licensed to Monsanto.

Along with regaining the use of the Intellicoat technology outside of the specific applications licensed to Monsanto under the amended Monsanto Agreement, Landec has assumed responsibility for Landec Ag's operating expenses and realizes all the revenues and profits from the sales of existing and new Intellicoat seed coating products.

The Monsanto Agreement also provides for a fee payable to Landec Ag of \$4 million if Monsanto elects to terminate the Monsanto Agreement or \$10 million if Monsanto elects to purchase the rights to the exclusive field. If the purchase option is exercised before December 2011, or if Monsanto elects to terminate the Monsanto Agreement, all annual license fees and supply payments that have not been paid to Landec Ag will become due upon the purchase or termination. If Monsanto does not exercise its purchase option by December 2011 Landec Ag will receive the termination fee and all rights to the Intellicoat seed coating technology will revert to Landec. Accordingly, we will receive aggregate minimum guaranteed payments of \$17 million for license fees and polymer supply payments over five years or \$23 million in aggregate maximum payments if Monsanto elects to purchase the rights to the exclusive field. The minimum guaranteed payments and the deferred gain of \$2 million per year described above will result in Landec recognizing revenue and operating income of \$5.4 million per year for fiscal years 2008 through 2011 and \$2.7 million per year for fiscal years 2007 and 2012. The incremental \$6 million to be received in the event Monsanto exercises the purchase option has been deferred and will be recognized upon the exercise of the purchase option. The fair value of the purchase option was determined by management to be less than the amount of the deferred revenue.

If Monsanto elects to purchase the rights to the exclusive field, a gain or loss on the sale will be recognized at the time of purchase. If Monsanto exercises its purchase option, we expect to enter into a new long-term supply agreement with Monsanto pursuant to which Landec would continue to be the exclusive supplier of Intellicoat polymer materials to Monsanto.

For each of the three and six months ended November 28, 2010 and November 29, 2009, Landec recognized \$1.35 million and \$2.7 million, respectively, in revenues from the Monsanto Agreement.

4. Other License Agreements

In December 2005, Landec entered into an exclusive licensing agreement with Aesthetic Sciences whereby Aesthetic Sciences paid Landec an upfront license fee of \$250,000 for the exclusive rights to use Landec's Intelimer® materials technology for the development of dermal fillers worldwide under the agreement. Landec would also receive royalties on the sale of products incorporating Landec's technology. In addition, the Company received shares of preferred stock originally valued at \$1.3 million which represented a 19.9% ownership interest in Aesthetic Sciences as of December 2005.

As part of the original agreement with Aesthetic Sciences, Landec was to receive additional shares upon the completion of a specific milestone. In November 2006, that milestone was met and as a result Landec received an additional 800,000 shares of preferred stock originally valued at \$481,000. The receipt of the additional 800,000 preferred shares did not change Landec's 19.9% ownership interest in Aesthetic Sciences. During fiscal year 2009, Aesthetic Sciences completed a second preferred stock offering in which Landec did not participate and as a result Landec's ownership interest in Aesthetic Sciences was 17.3% as of November 28, 2010 and May 30, 2010. Aesthetic Sciences sold the rights to its Smartfil™ Injector System on July 16, 2010. Landec has evaluated its investment in Aesthetic Sciences for impairment, utilizing a discounted cash flow analysis under the terms of the purchase agreement. Based on the terms of the recent sale, the Company had determined that its investment was other than temporarily impaired and therefore recorded an impairment charge of \$1.0 million as of May 30, 2010. The Company's carrying value of its investment in Aesthetic Sciences of \$792,000 is included in other non current assets.

In March 2006, Landec entered into an exclusive license and research and development agreement with Air Products and Chemicals, Inc. ("Air Products"). Landec will provide research and development support to Air Products for three years with a mutual option for two additional years. The license fees were recognized as license revenue over a three year period beginning March 2006. In addition, in accordance with the agreement, Landec receives 40% of the gross profit generated from the sale of products by Air Products occurring after April 1, 2007, that incorporate Landec's Intelimer materials.

In September 2007, the Company amended its licensing and supply agreement with Chiquita Brands International, Inc. ("Chiquita"). Under the terms of the amendment, the license for bananas was expanded to include additional exclusive fields using Landec's BreatheWay® packaging technology, and a new exclusive license was added for the sale and marketing of avocados and mangos using Landec's BreatheWay® packaging technology. The agreement with Chiquita, which terminates in December 2011 (Chiquita has a five year renewal option), requires Chiquita to pay annual gross profit minimums to Landec in order for Chiquita to maintain its exclusive license for bananas, avocados and mangos. Under the terms of the agreement, Chiquita must notify Landec before December 1st of each year whether it is going to maintain its exclusive license for the following calendar year and thus agree to pay the minimums for that year. Landec was notified by Chiquita in November 2010 that Chiquita wanted to maintain its exclusive license for calendar year 2011 and thus agreed at that time to pay the minimum gross profit for calendar year 2011.

In June 2010, Apio entered into an exclusive license agreement with Windset Farms ("Windset") for Windset to utilize Landec's proprietary breathable packaging to extend the shelf life of greenhouse grown cucumbers, peppers and tomatoes ("exclusive products"). In accordance with the agreement, Apio received and recorded a one-time upfront research and development fee of \$100,000 and will receive license fees equal to 3% of net revenue of the exclusive products utilizing the proprietary breathable packaging technology, with or without the BreatheWay® trademark. The ongoing license fees are subject to annual minimums of \$150,000 for each of the three types of exclusive product as each is added to the agreement. As of November 28, 2010 only one product has been added to the agreement and the first year minimum payment period ends June 2011.

5. Stock-Based Compensation

In the three and six months ended November 28, 2010, the Company recognized stock-based compensation expense of \$457,000 and \$962,000 or \$0.02 and \$0.04 per basic and diluted share, respectively, which included \$210,000 and \$454,000 for restricted stock unit awards and \$247,000 and \$508,000 for stock option grants, respectively. In the three and six months ended November 29, 2009, the Company recognized stock-based compensation expense of \$192,000 and \$412,000 or \$0.01 and \$0.02 per basic and diluted share, respectively, which included \$83,000 and \$202,000 for restricted stock unit awards and \$109,000 and \$210,000 for stock option grants, respectively.

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

| | Three Months Ended November 28, 2010 | Three Months Ended November 29, 2009 | Six Months Ended November 28, 2010 | Six Months Ended November 29, 2009 |
|--|---|---|---|---|
| Research and development | \$ 108,000 | \$ 45,000 | \$ 228,000 | \$ 94,000 |
| Selling, general and administrative | \$ 349,000 | \$ 147,000 | \$ 734,000 | \$ 318,000 |
| Total stock-based compensation expense | \$ 457,000 | \$ 192,000 | \$ 962,000 | \$ 412,000 |

As of November 28, 2010, there was \$3.8 million of total unrecognized compensation expense related to unvested equity compensation awards granted under the Company's incentive stock plans. Total expense is expected to be recognized over the weighted-average period of 2.3 years for stock options and 2.2 years for restricted stock unit awards.

6. Net Income Per Diluted Share

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

| | Three Months Ended November 28, 2010 | Three Months Ended November 29, 2009 | Six Months Ended November 28, 2010 | Six Months Ended November 29, 2009 |
|--|---|---|---|---|
| Numerator: | | | | |
| Net income available to common stockholders | \$ 2,055 | \$ 1,534 | \$ 4,359 | \$ 3,718 |
| Denominator: | | | | |
| Weighted average shares for basic net income per share | 26,324 | 26,360 | 26,412 | 26,355 |
| Effect of dilutive securities: | | | | |
| Stock options and restricted stock units | 236 | 316 | 227 | 315 |
| Weighted average shares for diluted net income per share | 26,560 | 26,676 | 26,639 | 26,670 |
| Diluted net income per share | \$ 0.08 | \$ 0.06 | \$ 0.16 | \$ 0.14 |

For the three months ended November 28, 2010 and November 29, 2009, the computation of the diluted net income per share excludes the impact of options to purchase 1.1 million shares and 1.1 million shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

For the six months ended November 28, 2010 and November 29, 2009, the computation of the diluted net income per share excludes the impact of options to purchase 2.0 million shares and 1.1 million shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

7. Income Taxes

The estimated annual effective tax rate for fiscal year 2011 is currently expected to be approximately 37%. The provision for income taxes for the three and six months ended November 28, 2010 was \$1.2 million and \$2.6 million, respectively.

As of May 30, 2010, the Company had unrecognized tax benefits of approximately \$868,000. Included in the balance of unrecognized tax benefits as of May 30, 2010 is approximately \$708,000 of tax benefits that, if recognized, would result in an adjustment to the Company's effective tax rate. The Company does not expect that the amounts of unrecognized tax benefits will change significantly within the next twelve months.

In accordance with accounting guidance, the Company has decided to classify interest and penalties related to uncertain tax positions as a component of its provision for income taxes. The Company did not accrue interest and penalties relating to the income tax on the unrecognized tax benefits as of November 28, 2010 and May 30, 2010 as the amounts were not significant.

Due to tax attribute carryforwards, the Company is subject to examination for tax years 1994 forward for U.S. tax purposes. The Company was also subject to examination in various state jurisdictions for tax years 1998 forward, none of which were individually significant.

8. Goodwill and Other Intangibles

The Company's intangible assets are comprised of customer relationships with an estimated useful life of twelve years and trademarks/trade names and goodwill with indefinite lives (collectively, "intangible assets"), which the Company recognized in accordance with accounting guidance (i) upon the acquisition of Lifecore in April 2010, our HA-based Biomaterials reporting unit, (ii) upon the acquisition of Apio in December 1999, which consists of our Food Products Technology and Export reporting units and (iii) from the repurchase of all non controlling interests in the common stock of Landec Ag in December 2006. Accounting guidance defines goodwill as "the excess of the cost of an acquired entity over the net of the estimated fair values of the assets acquired and the liabilities assumed at date of acquisition." All intangible assets, including goodwill, associated with the acquisitions of Lifecore and Apio were allocated to our HA-based Biomaterials reporting unit and our Food Products Technology reporting unit, respectively, pursuant to accounting guidance based upon the allocation of assets and liabilities acquired and consideration paid for each reporting unit. The consideration paid for the Export reporting unit approximated its fair market value at the time of acquisition, and therefore no intangible assets were recorded in connection with the Company's acquisition of this reporting unit. Goodwill associated with the Technology Licensing reporting unit consists entirely of goodwill resulting from the repurchase of the Landec Ag non controlling interests.

The Company tests its intangible assets for impairment at least annually, in accordance with accounting guidance. When evaluating indefinite-lived intangible assets for impairment, accounting guidance requires the Company to compare the fair value of the asset to its carrying value to determine if there is an impairment loss. When evaluating goodwill for impairment, accounting guidance requires the Company to first compare the fair value of the reporting unit to its carrying value to determine if there is an impairment loss. If the fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired; thus application of the second step of the two-step approach under accounting guidance is not required. Application of the intangible assets impairment tests requires significant judgment by management, including identification of reporting units, assignment of assets and liabilities to reporting units, assignment of intangible assets to reporting units, and the determination of the fair value of each indefinite-lived intangible asset and reporting unit based upon projections of future net cash flows, discount rates and market multiples, which judgments and projections are inherently uncertain.

Property, plant and equipment and finite-lived intangible assets are reviewed for possible impairment whenever events or changes in circumstances occur that indicate that the carrying amount of an asset (or asset group) may not be recoverable. The Company's impairment review requires significant management judgment including estimating the future success of product lines, future sales volumes, revenue and expense growth rates, alternative uses for the assets and estimated proceeds from the disposal of the assets. The Company conducts quarterly reviews of idle and underutilized equipment, and reviews business plans for possible impairment indicators. Impairment occurs when the carrying amount of the asset (or asset group) exceeds its estimated future undiscounted cash flows and the impairment is viewed as other than temporary. When impairment is indicated, an impairment charge is recorded for the difference between the asset's book value and its estimated fair value. Depending on the asset, estimated fair value may be determined either by use of a discounted cash flow model or by reference to estimated selling values of assets in similar condition. The use of different assumptions would increase or decrease the estimated fair value of assets and would increase or decrease any impairment measurement.

The Company tested its indefinite-lived intangible assets and goodwill for impairment as of July 25, 2010 and determined that no adjustments to the carrying values of the intangible assets were necessary as of that date. As of November 28, 2010, there were no impairment indicators identified by the Company in its analysis of impairment associated with the acquired indefinite-lived intangible assets. On a quarterly basis, the Company considers the need to update its most recent annual tests for possible impairment of its intangible assets, based on management's assessment of changes in its business and other economic factors since the most recent annual evaluation. Such changes, if significant or material, could indicate a need to update the most recent annual tests for impairment of the intangible assets during the current period. The results of these tests could lead to write-downs of the carrying values of the intangible assets in the current period.

The Company uses the discounted cash flow ("DCF") approach to develop an estimate of fair value. The DCF approach recognizes that current value is premised on the expected receipt of future economic benefits. Indications of value are developed by discounting projected future net cash flows to their present value at a rate that reflects both the current return requirements of the market and the risks inherent in the specific investment. The market approach was not used to value the Food Products Technology, Hyaluronan-based Biomaterials and Technology Licensing reporting units (the "Reporting Units") because insufficient market comparables exist to enable the Company to develop a reasonable fair value of its intangible assets due to the unique nature of each of the Company's Reporting Units.

The DCF approach requires the Company to exercise judgment in determining future business and financial forecasts and the related estimates of future net cash flows. Future net cash flows depend primarily on future product sales, which are inherently difficult to predict. These net cash flows are discounted at a rate that reflects both the current return requirements of the market and the risks inherent in the specific investment.

The DCF associated with the Technology Licensing reporting unit is based on the Monsanto Agreement with Monsanto. Under the Monsanto Agreement, Monsanto has agreed to pay Landec Ag a license fee of \$2.6 million in cash per year for five years beginning in December 2006, and a fee of \$4.0 million if Monsanto elects to terminate the Agreement, or \$10.0 million if Monsanto elects to purchase the rights to the exclusive field. If the purchase option is exercised before December 2011, or if Monsanto elects to terminate the Monsanto Agreement, all annual license fees that have not been paid to Landec Ag will become due upon the purchase or termination.

The DCF associated with the Food Products Technology reporting unit is based on management's five-year projection of revenues, gross profits and operating profits by fiscal year and assumes a 37% effective tax rate for each year. Management takes into account the historical trends of Apio and the industry categories in which Apio operates along with inflationary factors, current economic conditions, new product introductions, cost of sales, operating expenses, capital requirements and other relevant data when developing its projection.

The fair value of indefinite and finite-lived intangible assets associated with our acquisition of Lifecore on April 30, 2010, was determined using a DCF model based on management's five-year projections of revenues, gross profits and operating profits by fiscal year and assumes a 33% effective tax rate for each year. Management takes into account the historical trends of Lifecore and the industry categories in which Lifecore operates along with inflationary factors, current economic conditions, new product introductions, cost of sales, operating expenses, capital requirements and other relevant data when developing its projection. The trade name intangible asset was valued using the relief from royalty valuation method and the customer relationship intangible asset was valued using the multi-period excess earnings method. The fair value of goodwill was calculated as the excess of consideration paid, including the fair value of contingent consideration under the terms of the purchase agreement, over the fair value of the tangible and intangible assets acquired less liabilities assumed. The Company updated its analysis of the fair value of the indefinite-lived intangible assets and goodwill as of its annual impairment analysis date, concluding that the fair value of the Hyaluronan-based Biomaterials reporting unit, as determined by the DCF approach, exceeded its book value, and therefore, no intangible asset impairment was deemed to exist.

9. 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, 2010 | May 30, 2010 |
|------------------|----------------------|------------------|
| Raw materials | \$ 7,339 | \$ 6,868 |
| Work in progress | 3,524 | 2,013 |
| Finished goods | 8,881 | 7,226 |
| Total | <u>\$ 19,744</u> | <u>\$ 16,107</u> |

10. Debt

On April 30, 2010 in conjunction with the acquisition of Lifecore, Lifecore entered into a new \$20 million Credit Agreement with Wells Fargo Bank N.A. ("Wells Fargo") with a five year term that provides for equal monthly principal payments plus interest. All of Lifecore's assets, valued at approximately \$81 million as of November 28, 2010, have been pledged to secure the debt incurred pursuant to the Credit Agreement. Landec is the guarantor of the debt.

On August 19, 2004, Lifecore issued variable rate industrial revenue bonds ("IRB"). These bonds were assumed by Landec in the acquisition of Lifecore (see Note 2). The bonds are collateralized by a bank letter of credit which is secured by a first mortgage on the Company's facility in Chaska, Minnesota. In addition, the Company pays an annual remarketing fee equal to 0.125% and an annual letter of credit fee of 0.50%.

The Credit Agreement and the IRB contain certain restrictive covenants, which require Lifecore to meet certain financial tests, including minimum levels of net income, minimum quick ratio, minimum fixed coverage ratio and maximum capital expenditures.

On August 9, 2010 and September 14, 2010, the Company amended its Credit Agreement with Wells Fargo to modify certain financial covenants. As of November 28, 2010, the Company was in compliance with all covenants.

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

| | November 28, 2010 | May 30, 2010 |
|---|----------------------|------------------|
| Credit agreement with Wells Fargo; due in monthly payments of \$333,333 through April 30, 2015 with interest payable monthly at Libor plus 2% per annum | \$ 18,000 | \$ 19,667 |
| Industrial revenue bond issued by Lifecore; due in annual payments through 2020 with interest at a variable rate set weekly by the bond remarketing agent (0.48% and 2.56% at November 28, 2010 and May 30, 2010, respectively) | 3,830 | 4,103 |
| Total | 21,830 | 23,770 |
| Less current portion | (4,329) | (4,521) |
| Long-term portion | <u>\$ 17,501</u> | <u>\$ 19,249</u> |

The maturities on the IRB are held in a sinking fund account, recorded in Prepaid expenses and other current assets in the accompanying Consolidated Balance Sheets and is paid out each year on September 1st.

11. Derivative Financial Instruments

The Company is exposed to interest rate risks primarily through borrowings under its Credit Agreement with Wells Fargo (see Note 10). Interest on all of the Company's borrowings under its Credit Agreement is based upon variable interest rates. As of November 28, 2010, the Company had borrowings of \$18.0 million outstanding under its Credit Agreement which bear interest at a rate equal to the one-month LIBOR plus 2%. As of November 28, 2010, the interest rate on borrowings under the Credit Agreement was accruing at 2.375%.

In May 2010, the Company entered into a five-year interest rate swap agreement under the Company's Credit Agreement which expires on April 30, 2015. The interest rate swap was designated as a cash flow hedge of future interest payments of LIBOR and has a notional amount of \$20 million. As a result of the interest rate swap transaction, the Company fixed for a five-year period the interest rate at 4.24% subject to market based interest rate risk on \$20 million of borrowings under its Credit Agreement. The Company's obligations under the interest rate swap transaction as to the scheduled payments were guaranteed and secured on the same basis as its obligations under the Credit Agreement. As of November 28, 2010, the Company recorded to Other Comprehensive Loss on the Consolidated Balance Sheets an unrealized loss of \$331,000, net of taxes of \$210,000, as a result of the interest rate swap. The unrealized loss was based on Level 2 hierarchy for fair value measurements. If the interest rate swap is terminated or the debt borrowed is paid off prior to April 30, 2015, the amount of unrealized loss or gain included in Other Comprehensive Income (Loss) would be reclassified to earnings. The Company has no intentions of terminating the interest rate swap or prepaying the debt in the next twelve months. The interest rate swap liability is included in other non current liabilities as of November 28, 2010 and May 30, 2010.

12. Related Party

Apio provides cooling and distributing services for farms in which the Chairman of Apio (the "Apio Chairman") has a financial interest and purchases produce from those farms. Apio also purchases produce from Beachside Produce LLC for sale to third parties. Beachside Produce is owned by a group of entities and persons, including the Apio Chairman, that supply produce to Apio. Revenues and the resulting accounts receivable and cost of product sales and the resulting accounts payable are classified as related party items in the accompanying financial statements as of November 28, 2010 and May 30, 2010 and for the three and six months ended November 28, 2010 and November 29, 2009.

Apio's domestic commodity vegetable business was sold to Beachside Produce in 2003. The Apio Chairman is a 12.5% owner in Beachside Produce. During the three and six months ended November 28, 2010, the Company recognized revenues of \$173,000 and \$356,000, respectively, from the sale of products to Beachside Produce. During the three and six months ended November 29, 2009, the Company recognized revenues of \$213,000 and \$422,000, respectively, from the sale of products to Beachside Produce. The related accounts receivable from Beachside Produce are classified as related party in the accompanying financial statements as of November 28, 2010 and May 30, 2010.

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

13. Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income and other comprehensive income which for Landec includes changes in unrealized gains and losses on marketable securities and changes in unrealized gains and losses on its interest rate swap with Wells Fargo Bank, N.A. Accumulated other comprehensive loss is reported as a component of stockholders' equity. For the three and six months ended November 28, 2010, the net comprehensive loss from the unrealized loss on the interest rate swap and from unrealized gains on marketable securities, net of income taxes, was a net loss of \$0 and \$331,000, respectively. For both the three and six months ended November 29, 2009, the comprehensive income from unrealized gains on marketable securities, net of income taxes, was \$92,000. Accumulated other comprehensive income is reported as a component of stockholders' equity.

14. Stockholders' Equity

During the three and six months ended November 28, 2010, 37,747 and 55,266 shares of Common Stock, respectively, were issued upon the vesting of RSUs and upon the exercise of options under the Company's equity plans.

During the three and six months ended November 28, 2010, the Company granted options to purchase 26,000 and 36,000 shares, respectively, of common stock and 8,667 and 12,000, respectively, of restricted stock unit awards.

As of November 28, 2010 the Company has reserved 3.6 million shares of Common Stock for future issuance under its current and former equity plans.

On July 14, 2010, the Company announced that the Board of Directors of the Company had approved the establishment of a stock repurchase plan which allows for the repurchase of up to \$10 million of the Company's Common Stock. The Company may repurchase its common stock from time to time in open market purchases or in privately negotiated transactions. The timing and actual number of shares repurchased is at the discretion of management of the Company and will depend on a variety of factors, including stock price, corporate and regulatory requirements, market conditions, the relative attractiveness of other capital deployment opportunities and other corporate priorities. The stock repurchase program does not obligate Landec to acquire any amount of its common stock and the program may be modified, suspended or terminated at any time at the Company's discretion without prior notice. During the three and six months ended November 28, 2010, the Company repurchased on the open market 150,000 and 216,000 shares, respectively, of its Common Stock for \$822,000 and \$1.2 million, respectively.

15. Business Segment Reporting

Landec operates in four business segments: the Food Products Technology segment, the Export segment, the HA-based Biomaterials segment and the Technology Licensing segment. The Food Products Technology segment markets and packs specialty packaged whole and fresh-cut vegetables that incorporate the BreatheWay specialty packaging for the retail grocery, club store and food services industry. In addition, the Food Products Technology segment sells BreatheWay packaging to partners for non-vegetable products. The Export segment consists of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia. The HA-based Biomaterials segment sells products utilizing hyaluronan, a naturally occurring polysaccharide that is widely distributed in the extracellular matrix of connective tissues in both animals and humans for medical use in the ophthalmic, orthopedic and veterinary markets. The Technology Licensing segment licenses Landec's patented Intellicoat seed coatings to the farming industry and licenses the Company's Intelimer polymers for personal care products and other industrial products. Corporate includes corporate general and administrative expenses, non Food Products Technology interest income and Company-wide income tax expenses. All of the assets of the Company are located within the United States of America. The Company's international sales are primarily to Europe, Canada, Taiwan, Indonesia, China and Japan. Operations and identifiable assets by business segment consisted of the following (in thousands):

| Three Months Ended November 28, 2010 | Food Products Technology | Export | HA-based Biomaterials | Technology Licensing | Corporate | TOTAL |
|---|-----------------------------|-----------|--------------------------|-------------------------|------------|-----------|
| Net sales | \$ 40,649 | \$ 19,635 | \$ 8,422 | \$ 1,462 | \$ — | \$ 70,168 |
| International sales | \$ 4,166 | \$ 19,571 | \$ 6,325 | \$ — | \$ — | \$ 30,062 |
| Gross profit | \$ 3,752 | \$ 1,230 | \$ 5,411 | \$ 1,462 | \$ — | \$ 11,855 |
| Net income (loss) | \$ 853 | \$ 607 | \$ 2,841 | \$ 544 | \$ (2,790) | \$ 2,055 |
| Depreciation and amortization | \$ 777 | \$ 2 | \$ 478 | \$ 38 | \$ — | \$ 1,295 |
| Interest income | \$ 45 | \$ — | \$ 36 | \$ — | \$ 36 | \$ 117 |
| Interest expense | \$ — | \$ — | \$ 209 | \$ — | \$ — | \$ 209 |
| Income tax expense | \$ — | \$ — | \$ — | \$ — | \$ 1,209 | \$ 1,209 |

Three Months Ended November 29,
2009

| | | | | | | |
|-------------------------------|-----------|-----------|------|----------|------------|-----------|
| Net sales | \$ 42,326 | \$ 17,074 | \$ — | \$ 1,533 | \$ — | \$ 60,933 |
| International sales | \$ 3,571 | \$ 16,480 | \$ — | \$ — | \$ — | \$ 20,051 |
| Gross profit | \$ 4,755 | \$ 1,129 | \$ — | \$ 1,533 | \$ — | \$ 7,417 |
| Net income (loss) | \$ 1,983 | \$ 479 | \$ — | \$ 898 | \$ (1,826) | \$ 1,534 |
| Depreciation and amortization | \$ 735 | \$ 4 | \$ — | \$ 40 | \$ — | \$ 779 |
| Interest income | \$ 63 | \$ — | \$ — | \$ — | \$ 203 | \$ 266 |
| Interest expense | \$ 4 | \$ — | \$ — | \$ — | \$ — | \$ 4 |
| Income tax expense | \$ — | \$ — | \$ — | \$ — | \$ 895 | \$ 895 |

Six Months Ended November 28,
2010

| | | | | | | |
|-------------------------------|-----------|-----------|-----------|----------|------------|------------|
| Net sales | \$ 81,207 | \$ 36,118 | \$ 14,806 | \$ 2,989 | \$ — | \$ 135,120 |
| International sales | \$ 8,771 | \$ 36,017 | \$ 10,758 | \$ — | \$ — | \$ 55,546 |
| Gross profit | \$ 10,115 | \$ 2,161 | \$ 8,406 | \$ 2,989 | \$ — | \$ 23,671 |
| Net income (loss) | \$ 4,456 | \$ 984 | \$ 3,535 | \$ 1,116 | \$ (5,732) | \$ 4,359 |
| Depreciation and amortization | \$ 1,561 | \$ 4 | \$ 962 | \$ 75 | \$ — | \$ 2,602 |
| Interest income | \$ 74 | \$ — | \$ 62 | \$ — | \$ 88 | \$ 224 |
| Interest expense | \$ 2 | \$ — | \$ 433 | \$ — | \$ — | \$ 435 |
| Income tax expense | \$ — | \$ — | \$ — | \$ — | \$ 2,561 | \$ 2,561 |

Six Months Ended November 29,
2009

| | | | | | | |
|-------------------------------|-----------|-----------|------|----------|------------|------------|
| Net sales | \$ 84,181 | \$ 34,776 | \$ — | \$ 2,918 | \$ — | \$ 121,875 |
| International sales | \$ 7,007 | \$ 32,431 | \$ — | \$ — | \$ — | \$ 39,438 |
| Gross profit | \$ 11,136 | \$ 2,233 | \$ — | \$ 2,918 | \$ — | \$ 16,287 |
| Net income (loss) | \$ 5,381 | \$ 1,057 | \$ — | \$ 1,638 | \$ (4,358) | \$ 3,718 |
| Depreciation and amortization | \$ 1,452 | \$ 7 | \$ — | \$ 82 | \$ — | \$ 1,541 |
| Interest income | \$ 95 | \$ — | \$ — | \$ — | \$ 459 | \$ 554 |
| Interest expense | \$ 5 | \$ — | \$ — | \$ — | \$ — | \$ 5 |
| Income tax expense | \$ — | \$ — | \$ — | \$ — | \$ 2,176 | \$ 2,176 |

During the six months ended November 28, 2010 and November 29, 2009, sales to the Company's top five customers accounted for 43% and 47%, respectively, of revenues with the Company's top customer from the Food Products Technology segment, Costco Wholesale Corp., accounting for 15% and 19% for the six months ended November 28, 2010 and November 29, 2009, respectively. 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.

13. Subsequent Events

The Company has evaluated and disclosed subsequent events through the date of the issuance of the financial statements.

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

The following discussion should be read in conjunction with the unaudited consolidated financial statements and accompanying notes included in Part I-Item 1 of this Form 10-Q and the audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in Landec's Annual Report on Form 10-K for the fiscal year ended May 30, 2010.

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 Form 10-Q and those mentioned in Landec's Annual Report on Form 10-K for the fiscal year ended May 30, 2010. 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, 2010 filed with the Securities and Exchange Commission on August 12, 2010.

The Company

Landec Corporation and its subsidiaries ("Landec" or the "Company") design, develop, manufacture and sell polymer products for food and agricultural products, medical devices and licensed partner applications that incorporate Landec's patented polymer technologies. The Company has two proprietary polymer technology platforms: 1) Intelimer® polymers, and 2) Hyaluronan ("HA") biopolymers. The Company's proprietary polymer technologies are the foundation, and a key differentiating advantage, upon which Landec has built its business.

After the acquisition of Lifecore Biomedical, Inc. ("Lifecore") on April 30, 2010, Landec now has four core businesses – Food Products Technology, Export, HA-based Biomaterials and Technology Licensing, each of which is described below.

Our wholly-owned subsidiary, Apio, operates our Food Products Technology business, combining Landec's proprietary food packaging technology with the capabilities of a large national food supplier and value-added produce processor. In Apio's value-added operations, produce is processed by trimming, washing, mixing, and packaging into bags and trays that incorporate Landec's BreatheWay® membrane technology. The BreatheWay membrane increases shelf life and reduces shrink (waste) for retailers and, for certain products, eliminates the need for ice during the distribution cycle and helps to ensure that consumers receive fresh produce by the time the product makes its way through the supply chain. Apio also licenses the BreatheWay technology to Chiquita Brands International, Inc. ("Chiquita") for packaging and distribution of bananas and avocados and to Windset Farms for packaging of greenhouse grown cucumbers, peppers and tomatoes.

Apio also operates the Export business through its Cal Ex Trading Company ("Cal-Ex"). The Export business purchases and sells whole fruit and vegetable products to predominantly Asian markets.

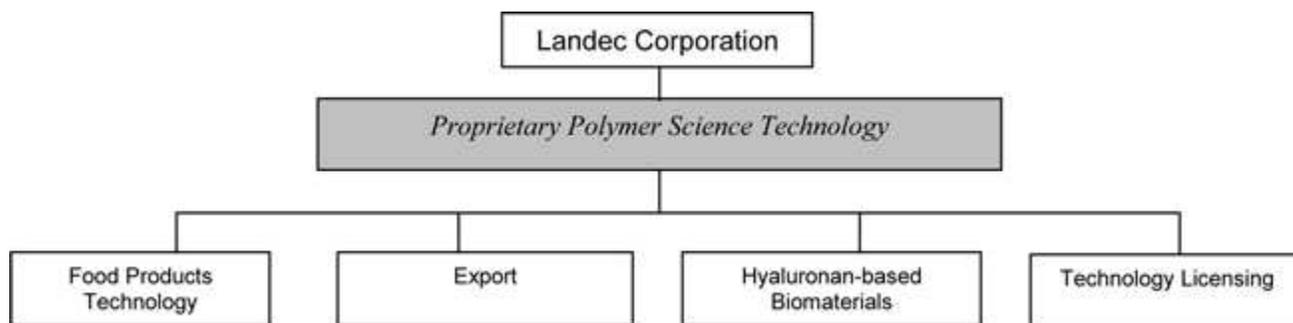
Our newly acquired wholly-owned subsidiary, Lifecore, operates our HA-based Biomaterials business and is principally involved in the development and manufacture of products utilizing hyaluronan, a naturally occurring polysaccharide that is widely distributed in the extracellular matrix of connective tissues in both animals and humans. Lifecore's products are primarily sold to three medical segments: (1) Ophthalmic, (2) Orthopedic and (3) Veterinary. Lifecore also supplies hyaluronan to customers pursuing other medical applications, such as aesthetic surgery, medical device coatings, tissue engineering and pharmaceuticals. Lifecore leverages its proprietary fermentation process to manufacture premium, pharmaceutical-grade hyaluronan, and its proprietary aseptic filling capabilities to deliver HA finished goods to its customers. Lifecore also manufactures and sells its own HA-based finished goods. Lifecore is known in the medical segments as a premium supplier of HA. Its name recognition allows Lifecore to acquire new customers and sell new products with only a small marketing or sales capability.

Landec's Technology Licensing business develops proprietary polymer technologies and applies them in a wide range of applications including seed coatings and treatments, temperature indicators, controlled release systems, drug delivery, pressure sensitive adhesives and personal care products. These applications are commercialized through partnerships with third parties resulting in licensing and royalty revenues. For example, Monsanto Company ("Monsanto") has an exclusive license to our Intellicoat® seed coating technology for specific seed treatment applications, Air Products and Chemicals, Inc. ("Air Products") has an exclusive license to our Intelimer polymers for personal care products and Nitta Corporation ("Nitta") licenses Landec's proprietary pressure sensitive adhesives for use in the manufacture of electronic components by their customers.

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

Description of Core Business

Landec participates in four core business segments: Apio, Inc. with the Food Products Technology and Export businesses, Lifecore Biomedical, Inc., with Hyaluronan-based Biomaterials business and Landec's Technology Licensing business.



Food Products Technology Business

The Company began marketing its proprietary Intelimer-based BreatheWay® membranes in 1996 for use in the fresh-cut produce packaging market, one of the fastest growing segments in the produce industry. Landec's proprietary BreatheWay packaging technology when combined with fresh-cut or whole produce results in packaged produce with increased shelf life and reduced shrink (waste) without the need for ice during the distribution cycle. The resulting products are referred to as "value-added" products. During the fiscal year ended May 30, 2010, Apio shipped nearly seventeen million cartons of produce to leading supermarket retailers, wholesalers, foodservice suppliers and club stores throughout the United States and internationally, primarily in Canada.

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

Value-Added Supplier: Apio has structured its business as a marketer and seller of fresh-cut and whole value-added produce. It is focused on selling products under its Eat Smart® brand and other brands for its fresh-cut and whole value-added products. As retail grocery and club store chains consolidate, Apio is well positioned as a single source of a broad range of products.

Reduced Farming Risks: Apio reduces its farming risk by not taking ownership of farmland, and instead, contracts with growers for produce. The year-round sourcing of produce is a key component to the fresh-cut and whole value-added processing business.

Lower Cost Structure: Apio has strategically invested in the rapidly growing fresh-cut and whole value-added business. Apio's 136,000 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 Apio's proprietary BreatheWay packaging technology. Apio's strategy is to operate one large central processing facility in one of California's largest, lowest cost growing regions (Santa Maria Valley) and use packaging technology to allow for the nationwide delivery of fresh produce products.

Expanded Product Line Using Technology: Apio, through the use of its BreatheWay packaging technology, is introducing on average fifteen new value-added products each year. These new product offerings range from various sizes of fresh-cut bagged products, to vegetable trays, to whole produce, to vegetable salads and snack packs. During the last twelve months, Apio has introduced 10 new products.

Apio established its Apio Packaging division in 2005 to advance the sales of BreatheWay packaging technology for shelf-life sensitive vegetables and fruit. The Company's specialty packaging for case liner products extends the shelf life of certain produce commodities up to 50%. This shelf life extension can enable the utilization of alternative distribution strategies to gain efficiencies or reach new markets while maintaining product quality to the end customer.

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

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

In fiscal year 2008, the Company expanded the use of its BreatheWay technology to include avocados and mangos under an expanded licensing agreement with Chiquita. Commercial sales of avocados packaged in Landec's BreatheWay packaging into the food service industry began late in fiscal year 2008 and commercial retail sales began in fiscal year 2010.

In June 2008, Apio entered into a collaboration agreement with Seminis Vegetable Seeds, Inc., a wholly-owned subsidiary of Monsanto, to develop novel broccoli and cauliflower products for the exclusive sale by Apio in the North American market. These novel products will be packaged in Landec's proprietary BreatheWay packaging and will be sold to retail grocery chains, club stores and the food service industry. Field trials for the initial target varieties began in the Fall of 2008 and will take several years to develop and initial commercial test markets are scheduled to begin in the Spring of 2011.

In June 2010, Apio entered into an exclusive license agreement with Windset Farms for Windset to utilize Landec's proprietary breathable packaging to extend the shelf life of greenhouse grown cucumbers, peppers and tomatoes.

Export Business

Export revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia through Apio's export company, Cal-Ex. The Export business is a buy/sell business that realizes a commission-based margin on average in the 6-7% range.

Hyaluronan-based Biomaterials Business

Our HA-based Biomaterials business, operated through our Lifecore subsidiary, was acquired by Landec on April 30, 2010.

Lifecore intends to use its proprietary fermentation process and aseptic formulation and filling expertise to be a leader in the development of HA-based products for multiple applications and to take advantage of non-HA device and drug opportunities which leverage our expertise in HA manufacture and syringe filling capabilities. Elements of Lifecore's strategy include the following:

- *Establish strategic relationships with market leaders.* Lifecore will continue to develop applications for products with partners who have strong marketing, sales and distribution capabilities to end-user markets. Lifecore through its strong reputation and history of providing premium HA products has been able to establish long-term relationships with the market leading companies such as Alcon and Abbott Medical Optics in ophthalmology, and Musculoskeletal Transplant Foundation (MTF) and Novartis AG in orthopedics.
- *Expand medical applications for hyaluronan.* Due to the growing knowledge of the unique characteristics of HA and the role it plays in normal physiology, Lifecore continues to identify and pursue further uses for HA in other medical applications, such as wound care, aesthetic surgery, adhesion prevention, drug delivery, device coatings and pharmaceuticals. Further applications may involve expanding process development activity and/or additional licensing of technology.
- *Utilize manufacturing infrastructure to pursue contract aseptic filling and fermentation opportunities.* Lifecore will continue to evaluate providing contract services for opportunities that are suited for the capital and facility investment related to aseptic filling equipment, fermentation and purification.
- *Maintain flexibility in product development and supply relationships.* Lifecore's vertically integrated development and manufacturing capabilities allow it to establish a variety of relationships with global corporate partners. Lifecore's role in these relationships extends from supplying HA raw materials to manufacturing of aseptically-packaged, finished sterile products to developing and manufacturing its own proprietary products.

Technology Licensing Businesses

The Technology and Market Opportunity: Intellicoat Seed Coatings

Following the sale of FCD, Landec Ag's strategy has been to work closely with Monsanto to further develop our patented, functional polymer coating technology for sale and/or licensing to the seed industry. In accordance with its license and supply agreement with Monsanto, Landec Ag is currently focused on commercializing products for the seed corn market and then plans to broaden the technology to other seed crop applications.

Landec's Intellicoat seed coating applications are designed to control seed germination timing, increase crop yields, reduce risks and extend crop-planting windows. These coatings are currently available on hybrid corn, soybeans and male inbred corn used for seed production. In fiscal year 2000, Landec Ag launched its first commercial product, Pollinator Plus ® coatings, which is a coating application used by seed companies as a method for spreading pollination to increase yields and reduce risk in the production of hybrid seed corn. There are approximately 650,000 acres of seed production in the United States and in 2010 Pollinator Plus was used by 10 seed companies on approximately 18% of the seed corn production acres in the U.S.

Monsanto announced in 2008 that it had formed a new business called the Seed Treatment Business which will allow Monsanto to develop its seed treatment requirements internally. The concept of seed treatments is to place an insecticide or fungicide directly onto the seed surface in order to protect the seed and the seedling as it emerges. Landec's Intellicoat seed coating technology could be an integral and proprietary part of Monsanto's commitment to building a major position in seed treatments worldwide by using Landec's seed coatings as a "carrier" of insecticides/fungicides which can be dispensed at the appropriate time based on time or soil temperature. During fiscal year 2010 we amended our agreement with Monsanto and as a result our development activities are focused on a specific technology of interest to Monsanto.

The Technology and Market Opportunity: Intelimer Polymer Applications

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

Industrial Materials and Adhesives

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

Intelimer Latent Catalyst Polymer Systems

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

Personal Care and Cosmetic Applications

Landec's personal care and cosmetic applications strategy is focused on supplying Intelimer materials to industry leaders for use in lotions and creams, as well as color cosmetics, lipsticks and hair care. The Company's partner, Air Products, is currently shipping products to L'Oreal, The Mentholatum Company and other companies for use in lotions and creams. The rights to develop and sell Landec's polymers for personal care products were licensed to Air Products in March 2006 along with the latent catalyst rights.

Intelimer Drug Delivery Polymers

Landec has been developing both biodegradable and non-biodegradable polymers for use in drug delivery applications targeting the use of its highly crystalline polymers and the tunable physical properties to minimize or eliminate burst, extend drug release profiles and deliver novel valuable properties to the pharma industry.

Results of Operations

Revenues (in thousands):

| | <u>Three months ended 11/28/10</u> | <u>Three months ended 11/29/09</u> | <u>Change</u> | <u>Six months ended 11/28/10</u> | <u>Six months ended 11/29/09</u> | <u>Change</u> |
|----------------------------|--|--|---------------|--------------------------------------|--------------------------------------|---------------|
| Apio Value Added | \$ 40,179 | \$ 41,733 | (4)% | \$ 79,824 | \$ 83,024 | (4)% |
| Apio Packaging | 470 | 593 | (21)% | 1,383 | 1,157 | 20% |
| Technology Subtotal | 40,649 | 42,326 | (4)% | 81,207 | 84,181 | (4)% |
| Apio Export | 19,635 | 17,074 | 15% | 36,118 | 34,776 | 4% |
| Total Apio | 60,284 | 59,400 | 1% | 117,325 | 118,957 | (1)% |
| HA | 8,422 | — | N/M | 14,806 | — | N/M |
| Tech. Licensing | 1,462 | 1,533 | (5)% | 2,989 | 2,918 | 2% |
| Total Revenues | \$ 70,168 | \$ 60,933 | 15% | \$ 135,120 | \$ 121,875 | 11% |

Apio Value Added

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

The decrease in Apio's value-added revenues for the three and six months ended November 28, 2010 compared to the same periods last year was primarily due to a decrease in value-added unit sales volumes of 10% and 9%, respectively, partially offset by a year over year mix change to greater sales of higher priced tray products from lower priced bag products compared to the same periods last year.

Apio Packaging

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

The decrease in Apio packaging revenues for the three months ended November 28, 2010 compared to the same period last year and the increase in Apio packaging revenues for the six months ended November 28, 2010 compared to the same period last year was primarily due to the timing of the sale of BreatheWay membranes to Chiquita for use on avocado applications. Chiquita purchased a sizable quantity of BreatheWay membranes during the first quarter of fiscal year 2011 and therefore purchased less during the second quarter of fiscal year 2011.

Apio Export

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

The increase in revenues in Apio's export business for the three and six months ended November 28, 2010 compared to the same periods last year was primarily due to an 18% and 5%, respectively, increase in export sales volumes as a result of an increased supply of fruit to export.

Hyaluronan-based ("HA") Biomaterials

The Company's Lifecore subsidiary principally generates revenue through the sale of products containing HA. Lifecore was acquired on April 30, 2010.

Technology Licensing

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

The change in Technology Licensing revenues for the three and six months ended November 28, 2010 compared to the same periods of the prior year was not significant to consolidated Landec revenues.

Gross Profit (in thousands):

| | <u>Three months</u> <u>ended 11/28/10</u> | <u>Three months</u> <u>ended 11/29/09</u> | <u>Change</u> | <u>Six months</u> <u>ended 11/28/10</u> | <u>Six months</u> <u>ended 11/29/09</u> | <u>Change</u> |
|----------------------------|--|--|---------------|--|--|---------------|
| Apio Value Added | \$ 3,341 | \$ 4,250 | (21)% | \$ 8,952 | \$ 10,115 | (11)% |
| Apio Packaging | 411 | 505 | (19)% | 1,163 | 1,021 | 14% |
| Technology Subtotal | 3,752 | 4,755 | (21)% | 10,115 | 11,136 | (9)% |
| Apio Export | 1,230 | 1,129 | 9% | 2,161 | 2,233 | (3)% |
| Total Apio | 4,982 | 5,884 | (15)% | 12,276 | 13,369 | (8)% |
| HA | 5,411 | — | N/M | 8,406 | — | N/M |
| Tech. Licensing | 1,462 | 1,533 | (5)% | 2,989 | 2,918 | 2% |
| Total Gross Profit | \$ 11,855 | \$ 7,417 | 60% | \$ 23,671 | \$ 16,287 | 45% |

General

There are numerous factors that can influence gross profit including product mix, customer mix, manufacturing costs, volume, sale discounts and charges for excess or obsolete inventory, to name a few. Many of these factors influence or are interrelated with other factors. Therefore, it is difficult to precisely quantify the impact of each item individually. The Company includes in cost of sales all of the costs related to the sale of products in accordance with U.S. generally accepted accounting principles. These costs include the following: raw materials (including produce, casein, seeds and packaging), direct labor, overhead (including indirect labor, depreciation, and facility related costs) and shipping and shipping related costs. The following discussion surrounding gross profit includes management's best estimates of the reasons for the changes for the three and six months ended November 28, 2010 compared to the same periods last year as outlined in the table above.

Apio Value-Added

The decrease in gross profit for Apio's value-added specialty packaging vegetable business for the three and six months ended November 28, 2010 compared to the same periods last year was primarily due to (1) the decrease in revenues for both periods, (2) shortages of produce due to cold and wet weather in California during November which resulted in the Company buying produce on the open market at prices above contracted prices coupled with production inefficiencies. These decreases were partially offset by a year over year mix change to greater sales of higher margin tray products from lower margin bag products compared to the same periods last year.

Apio Packaging

The decrease in Apio packaging gross profits for the three months ended November 28, 2010 compared to the same period last year and the increase in Apio packaging gross profits for the six months ended November 28, 2010 compared to the same period last year was primarily due to the timing of the sale of BreatheWay membranes to Chiquita for use on avocado applications. Chiquita purchased a sizable quantity of BreatheWay membranes during the first quarter of fiscal year 2011 and therefore purchased less during the second quarter of fiscal year 2011.

Apio Export

Apio's export business is a buy/sell business that realizes a commission-based margin in the 6-7% range. The increase in gross profit for Apio's Export business during the three months ended November 28, 2010 compared to the same period last year was due to a 15% increase in revenues in lower margin fruit exports. The decrease in gross profit for Apio's Export business during the six months ended November 28, 2010 compared to the same period last year was due to a decrease in average margins due to higher sales volumes which tend to lower the margins on commissioned-based products.

HA-based Biomaterials

Lifecore was acquired on April 30, 2010.

Technology Licensing

The decrease in Technology Licensing gross profit for the three and six months ended November 28, 2010 compared to the same periods of the prior year was not significant to consolidated Landec revenues.

Operating Expenses (in thousands):

| | <u>Three months</u> <u>ended 11/28/10</u> | <u>Three months</u> <u>ended 11/29/09</u> | <u>Change</u> | <u>Six months</u> <u>ended 11/28/10</u> | <u>Six months</u> <u>ended 11/29/09</u> | <u>Change</u> |
|---|--|--|---------------|--|--|---------------|
| Research and Development: | | | | | | |
| Apio | \$ 246 | \$ 307 | (20)% | \$ 469 | \$ 601 | (22)% |
| HA | 1,091 | — | N/M | 2,145 | — | N/M |
| Tech. Licensing | 918 | 635 | 45% | 1,873 | 1,280 | 46% |
| Total R&D | \$ 2,255 | \$ 942 | 139% | \$ 4,487 | \$ 1,881 | 139% |
| Selling, General and Administrative: | | | | | | |
| Apio | \$ 3,190 | \$ 3,048 | 5% | \$ 6,211 | \$ 6,111 | 2% |
| HA | 1,263 | — | N/M | 2,252 | — | N/M |
| Corporate | 1,619 | 1,134 | 43% | 3,262 | 2,641 | 24% |
| Total S,G&A | \$ 6,072 | \$ 4,182 | 45% | \$ 11,725 | \$ 8,752 | 34% |

Research and Development

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

The increase in research and development expenses for the three and six months ended November 28, 2010 compared to the same periods last year was primarily due to the research and development expenses from Lifecore and from an increase in scientific staff at Corporate to support the development of new product applications.

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 and six months ended November 28, 2010 compared to the same periods last year was primarily due to the selling, general and administrative expenses for Lifecore.

Other (in thousands):

| | <i>Three months ended 11/28/10</i> | <i>Three months ended 11/29/09</i> | <i>Change</i> | <i>Six months ended 11/28/10</i> | <i>Six months ended 11/29/09</i> | <i>Change</i> |
|--------------------------------|--|--|---------------|--------------------------------------|--------------------------------------|---------------|
| <i>Interest Income</i> | \$ 117 | \$ 266 | (56)% | \$ 224 | \$ 554 | (60)% |
| <i>Interest Expense</i> | \$ (209) | \$ (4) | N/M | \$ (435) | \$ (5) | N/M |
| <i>Other Expense</i> | \$ (44) | \$ — | N/M | \$ (102) | \$ — | N/M |
| <i>Income Taxes</i> | \$ (1,209) | \$ (895) | 35% | \$ (2,561) | \$ (2,176) | 18% |
| <i>Noncontrolling Interest</i> | \$ (128) | \$ (126) | 2% | \$ (226) | \$ (309) | (27)% |

Interest Income

The decrease in interest income for the three and six months ended November 28, 2010 compared to the same periods last year was primarily due to less cash to invest because of the cash used to acquire Lifecore and from lower yields on investments due to declines in interest rates.

Interest Expense

The increase in interest expense during the three and six months ended November 28, 2010 compared to the same periods last year was due to payments in connection with the facility entered into on April 30, 2010 in conjunction with the acquisition of Lifecore.

Other Expenses

The other expense is for the amortization of the discount on Lifecore's earnout obligation (see Note 2).

Income Taxes

The increase in the income tax expense for the three and six months ended November 28, 2010 is due to a 33% and 15% increase, respectively, in net income before taxes compared to the same periods last year.

Noncontrolling Interest

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

The increase in the noncontrolling interest for the three and six months ended November 28, 2010 compared to the same periods last year was not significant.

Liquidity and Capital Resources

As of November 28, 2010, the Company had cash and cash equivalents of \$5.4 million, a net decrease of \$22.4 million from \$27.8 million at May 30, 2010.

Cash Flow from Operating Activities

Landec generated \$2.1 million of cash flow from operating activities during the six months ended November 28, 2010 compared to generating \$4.2 million of cash flow from operating activities for the six months ended November 29, 2009. The primary sources of cash from operating activities during the six months ended November 28, 2010 were from generating \$4.4 million of net income and non-cash related net expenses of \$2.5 million, partially offset by a net decrease of \$4.8 million in working capital. The primary changes in working capital were (a) a \$5.8 million increase in accounts receivable due to an increase in accounts receivable at Lifecore as a result of the timing of shipments during the quarter of which over half occurred in November and an increase in accounts receivable at Apio due to increased export sales during the month of November, (b) a \$3.6 million increase in inventories due to an increase in inventories at Apio in advance of its busy holiday season and an increase in inventories at Lifecore due to the build up of inventory for new expected business during the second half of fiscal year 2011, (c) a \$1.5 million decrease in prepaid expenses primarily due to amortization of prepaid insurance and taxes and collection of our advances on produce, (d) a \$4.6 million increase in accounts payable resulting from the timing of payments and the increase in cost of sales due to produce shortages during November 2010, and (e) a \$2.2 million decrease in deferred revenue primarily due to recognizing \$2.3 million of revenue associated with deferred revenue from the Monsanto licensing agreement during the first six months of fiscal year 2011.

Cash Flow from Investing Activities

Net cash used in investing activities for the six months ended November 28, 2010 was \$22.6 million compared to \$46.4 million for the same period last year. The primary uses of cash in investing activities during the first six months of fiscal year 2011 were from the purchase of \$3.5 million of property, plant and equipment primarily for the further expansion of Apio's value-added processing facility and the further automation of Apio's value-added processing facility and the purchase of equipment at Lifecore to support the addition of new customers and from the net purchase of \$19.2 million of marketable securities.

Cash Flow from Financing Activities

Net cash used in financing activities for the six months ended November 28, 2010 was \$1.8 compared to net cash provided by financing activities of \$1.0 million for the same period last year. The use of cash from financing activities during the first six months of fiscal year 2011 was primarily from \$1.9 million of long-term debt payments and the repurchase of \$1.2 million of the Company's outstanding Common Stock, partially offset by the tax benefit from stock-based compensation of \$1.6 million.

Capital Expenditures

During the six months ended November 28, 2010, Landec continued its expansion of Apio's value-added processing facility and purchased vegetable processing equipment to support the further automation of Apio's value added processing facility and it purchased equipment to support the addition of new customers at Lifecore. These expenditures represented the majority of the \$3.5 million of capital expenditures.

Debt

On April 30, 2010 in conjunction with the acquisition of Lifecore, Lifecore entered into a \$20 million Credit Agreement with Wells Fargo Bank N.A. ("Wells Fargo") with a five year term that provides for equal monthly principal payments plus interest. The Credit Agreement contains certain restrictive covenants, which require Lifecore to meet certain financial tests, including minimum levels of net income, minimum quick ratio, minimum fixed coverage ratio and maximum capital expenditures. All of Lifecore's assets have been pledged to secure the debt incurred pursuant to the Credit Agreement. Landec is the guarantor of the debt. On August 9, 2010 and September 14, 2010, the Company amended its Credit Agreement with Wells Fargo to amend certain financial covenants. As of November 28, 2010, \$18 million was outstanding under the Credit Agreement. The Company was in compliance with all financial covenants as of November 28, 2010.

On May 4, 2010, the Company entered into an interest rate swap agreement that has the economic effect of modifying the variable interest obligations associated with the \$20 million Credit Agreement so that the interest payable is effectively fixed at a rate of 4.24% (see Note 11).

On August 19, 2004, Lifecore issued variable rate industrial revenue bonds (“IRB”). These bonds were assumed by Landec in the acquisition of Lifecore (see Note 2). The bonds are collateralized by a bank letter of credit which is secured by a first mortgage on the Company’s facility in Chaska, Minnesota. In addition, the Company pays an annual remarketing fee equal to 0.125% and an annual letter of credit fee of 0.50%.

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

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

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

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

None.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting during the quarter ended November 28, 2010 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There have been no material changes to the Company's risk factors which are included and described in the Form 10-K for the fiscal year ended May 30, 2010 filed with the Securities and Exchange Commission on August 12, 2010.

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

(c) The following table contains the Company's stock repurchases of equity securities for the second quarter of the fiscal year 2011:

Issuer Purchases of Equity Securities

| Period (1) | (a) Total Number of Shares (or Units) Purchased | (b) Average Price Paid per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|--|--|---|---|---|
| Month #1 | | | | |
| August 30, 2010 to September 26, 2010 | 149,248 | \$ 5.49 | 149,248 | \$ 8,818,000 |
| Month #2 | | | | |
| September 27, 2010 to October 24, 2010 | 400 | \$ 5.50 | 400 | \$ 8,816,000 |
| Month #3 | | | | |
| October 25, 2010 to November 28, 2010 | -0- | -0- | -0- | \$ 8,816,000 |
| TOTAL | <u>149,648</u> | <u>\$ 5.50</u> | <u>149,648</u> | <u>\$ 8,816,000</u> |

(1) The reported periods conform to the Company's fiscal calendar composed of thirteen weeks under a 4 week, 4 week and 5 week structure.

On July 14, 2010, the Company announced that the Board of Directors of the Company had approved the establishment of a stock repurchase plan which allows for the repurchase of up to \$10 million of the Company's Common Stock. The Company may repurchase its Common Stock from time to time in open market purchases or in privately negotiated transactions. The timing and actual number of shares purchased is at the discretion of management of the Company and will depend on a variety of factors, including stock price, corporate and regulatory requirements, market conditions, the relative attractiveness of other capital deployment opportunities and other corporate priorities. The stock repurchase program does not obligate Landec to acquire any amount of its Common Stock and the program may be modified, suspended or terminated at any time at the Company's discretion without prior notice.

Item 3. Defaults Upon Senior Securities

None.

Item 4. {Removed and Reserved}

Item 5. Other Information

None.

Item 6. Exhibits

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

+ 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 6, 2011

CERTIFICATION

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 officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this 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 officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent 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 6, 2011

/s/ Gary T. Steele

Gary T. Steele
Chief Executive Officer

CERTIFICATION

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 officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles ;
 - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this 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 officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent 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 6, 2011

/s/ Gregory S. Skinner

Gregory S. Skinner
Chief Financial Officer

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

In connection with the Quarterly Report of Landec Corporation (the "Company") on Form 10-Q for the period ending November 28, 2010 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 6, 2011

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

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

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

In connection with the Quarterly Report of Landec Corporation (the "Company") on Form 10-Q for the period ending November 28, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gregory S. Skinner, Vice President of Finance and Administration 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 6, 2011

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

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