

LANDEC CORP \CA\
Form 10-K
July 27, 2007

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

FORM 10-K

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

For the Fiscal Year Ended May 27, 2007, or

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

For the Transition period for _____ to _____.

Commission file number: **0-27446**

LANDEC CORPORATION

(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)

94-3025618
(IRS Employer
Identification Number)

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

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

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock	The NASDAQ Stock Market, Inc.

Securities registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ☐ No ☒

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

Yes ☒ No ☐

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

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

Large Accelerated Filer ☐

Accelerated Filer ☒

Non Accelerated Filer ☐

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

Yes ☐ No ☒

The aggregate market value of voting stock held by non-affiliates of the Registrant was approximately \$209,754,000 as of November 26, 2006, the last business day of the registrant’s most recently completed second fiscal quarter, based upon the closing sales price on The NASDAQ Global Select Market reported for such date. Shares of Common Stock held by each officer and director and by each person who owns 10% or more of the outstanding Common Stock have been excluded from such calculation in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of July 13, 2007, there were 25,904,212 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement relating to its October 2007 Annual Meeting of Shareholders, which statement will be filed not later than 120 days after the end of the fiscal year covered by this report, are incorporated by reference in Part III hereof.

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LANDEC CORPORATION
ANNUAL REPORT ON FORM 10-K

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PART I

Item 1. *Business*

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

General

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

The principal products and services offered by the Company in its two historical core businesses - Food Products Technology and Agricultural Seed Technology - and in the Technology Licensing/Research and Development business are described below. Financial information concerning the industry segments for which the Company reported its operations during fiscal years 2005, 2006 and 2007 is summarized in Note 15 to the Consolidated Financial Statements.

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

Landec’s Agricultural Seed Technology business is operated through a subsidiary, Landec Ag, Inc. (“Landec Ag”) which, prior to the sale of Fielder’s Choice Direct (“FCD”) on December 1, 2006 to American Seeds, Inc. (ASI), a wholly owned subsidiary of Monsanto Company (“Monsanto”), (see Note 2 to the Consolidated Financial Statements), combined the Company’s proprietary Intellicoat® seed coating technology with FCD’s unique direct marketing and sales capabilities.

In addition to its two historical core businesses, the Company also operates a Technology Licensing business that licenses products to, and conducts joint research and development with industry leaders outside of Landec’s core businesses, such as Air Products and Chemicals, Inc. (“Air Products”). The Company also engages in research and development activities and supplies products based on its Intelimer® polymer technology to companies such as Akzo-Nobel Chemicals B.V. (“Akzo-Nobel”) and L’Oreal of Paris (“L’Oreal”) (these supply activities are included in the technology fields licensed to Air Products). For segment disclosure purposes, the Technology Licensing business is included in Corporate and Other in Note 15 to the Consolidated Financial Statements.

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

be tailored by Landec to occur at specific temperatures, thereby offering substantial competitive advantages in the Company's target markets.

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

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Technology Overview

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

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

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

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

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

Description of Core Business

The Company has historically participated in two core business segments- Food Products Technology and Agricultural Seed Technology. In addition to these two core segments, Landec licenses technology and conducts ongoing research and development and supplies materials through its Technology Licensing 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. In 1999, the Company acquired Apio, its then largest customer in the Food Products Technology business and one of the nation's leading marketers and packers of produce and specialty packaged fresh-cut vegetables. Apio utilizes state-of-the-art fresh-cut produce processing technology and year-round access to specialty packaged produce products which Apio distributes to the top U.S. retail grocery chains, major club stores and to the foodservice industry. The Company's proprietary BreatheWay packaging business has been combined with Apio into a subsidiary that retains the Apio, Inc. name. This vertical integration within the Food Products Technology business gives Landec direct access to the large and growing fresh-cut and whole produce market.

The Technology and Market Opportunity: Proprietary BreatheWay Packaging Technology

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

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

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

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

The respiration rate of produce also varies with temperature. As temperature increases, produce generally respire at a higher rate, which speeds up the aging process, resulting in shortened shelf life and increased potential for decay, spoilage, and loss of texture and dehydration. As produce is transported from the processing plant through the refrigerated distribution chain to foodservice locations, retail grocery stores and club stores, and finally to the ultimate

consumer, temperatures can fluctuate significantly. Therefore, temperature control is a constant challenge in preserving the quality of fresh-cut and whole produce — a challenge few current packaging films can compensate for. The Company believes that its temperature-responsive BreatheWay packaging technology is well suited to the challenges of the produce distribution process.

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

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

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

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

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

The Business: Apio, Inc.

Apio had revenues of approximately \$206 million for the fiscal year ended May 27, 2007, \$195 million for the fiscal year ended May 28, 2006 and \$179 million for the fiscal year ended May 29, 2005.

Based in Guadalupe, California, Apio, when acquired in 1999, consisted of two major businesses - first, the “fee-for-service” selling and marketing of whole produce and second, the specialty packaged fresh-cut and whole value-added processed products that are washed and packaged in our proprietary BreatheWay packaging. The “fee-for-service” business historically included field harvesting and packing, cooling and marketing of vegetables and fruit on a contract basis for growers in California's Santa Maria, San Joaquin and Imperial Valleys as well as in Arizona and Mexico. The Company exited this business and certain assets associated with the business were sold in

June 2003 to Beachside Produce, LLC. Beachside Produce is owned by a group of entities and persons that supply produce to Apio, including Nicholas Tompkins, Apio's President and Chief Executive Officer. Under the terms of the sale, Beachside Produce purchased certain equipment and carton inventory from Apio in exchange for approximately \$410,000. In connection with the sale, Beachside Produce has paid Apio royalty fees per carton sold for the use of Apio's brand names and Beachside Produce and its owner growers entered into a long-term supply agreement with Apio to supply produce to Apio for its fresh-cut value-added business. The fresh-cut value-added processed products business markets a variety of fresh-cut and whole vegetables to the top retail grocery chains, club stores and foodservice suppliers. During the fiscal year ended May 27, 2007, Apio shipped nearly seventeen million cartons of produce to leading supermarket retailers, wholesalers, foodservice suppliers and club stores throughout the United States and internationally, primarily in Asia.

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

- **Value-Added Supplier:** Apio has structured its business as a marketer and seller of fresh-cut and whole value-added produce. It is focused on selling products under its Eat Smart® brand and other brands for its fresh-cut and whole value-added products. As retail grocery and club store chains consolidate, Apio is well positioned as a single source of a broad range of products.
- **Reduced Farming Risks:** Apio reduces its farming risk by not taking ownership of farmland, and instead, contracts with growers for produce. The year-round sourcing of produce is a key component to the fresh-cut and whole value-added processing business.
- **Lower Cost Structure:** Apio has strategically invested in the rapidly growing fresh-cut and whole value-added business. Apio's 96,000 square foot value-added processing plant, which was recently expanded from 60,000 square feet, is automated with state-of-the-art vegetable processing equipment. Virtually all of Apio's value-added products utilize Apio's proprietary BreatheWay packaging technology. Apio's strategy is to operate one large central processing facility in one of California's largest, lowest cost growing regions (Santa Maria Valley) and use packaging technology to allow for the nationwide delivery of fresh produce products.
- **Export Capability:** Apio is uniquely positioned to benefit from the growth in export sales to Asia and Europe over the next decade with its export business, Cal-Ex. Through Cal-Ex, Apio is currently one of the largest U.S. exporters of broccoli to Asia and is selling its iceless products to Asia using proprietary BreatheWay packaging technology.
- **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 a meal line of products. During fiscal year 2007, Apio introduced 15 new products.

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

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

The initial market focus for the BreatheWay banana packaging technology using Chiquita® Brand bananas will be commercial outlets that normally do not sell bananas because of their short shelf-life - outlets such as quick serve restaurants, convenience stores, drug stores and coffee chain outlets. Chiquita has recently started market testing the sale of bananas packaged with Landec's BreatheWay technology to retail grocery chains.

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

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

In fiscal year 2007, sales of the value-added retail vegetable tray line and the value-added 12-ounce bag line each grew 18% compared to fiscal year 2006.

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

In addition, the Company is in early commercialization for new lines of fresh cut vegetable side dishes, vegetable salads and vegetable snacks.

Agricultural Seed Technology Business

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

The Technology and Market Opportunity: Intellicoat Seed Coatings

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

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

The Business: Landec Ag

Landec Ag had revenues of approximately \$2.8 million for the fiscal year ended May 27, 2007, \$34.1 million for the fiscal year ended May 28, 2006 and \$25.6 million for the fiscal year ended May 29, 2005. Revenues for fiscal year 2007 declined significantly as a result of the sale of FCD on December 1, 2006.

On December 1, 2006, Landec sold FCD, which included the Fielder's Choice Direct® and Heartland Hybrid® brands, to ASI. The acquisition price for FCD was \$50 million in cash paid at the close. In addition, the Company could have earned up to an additional \$5 million based on FCD results for the twelve months ended May 31, 2007. None of the earn-out was earned. During the fiscal year 2007, Landec recorded income from the sale, net of direct expenses and bonuses, of \$22.7 million. The income that was recorded is equal to the difference between the fair value of FCD of \$40 million and its net book value, less direct selling expenses and bonuses. In accordance with generally accepted accounting principles, the portion of the \$50 million of proceeds in excess of the fair value of FCD, or \$10 million, will be allocated to the technology license agreement described below and will be recognized as revenue ratably over the five year term of the technology license agreement or \$2 million per year beginning December 1, 2006. The fair value was determined by management with the assistance of an independent appraiser.

On December 1, 2006, Landec also entered into a five-year co-exclusive technology license and polymer supply agreement ("the Agreement") with Monsanto for the use of Landec's Intellicoat polymer seed coating technology. Under the terms of the Agreement, Monsanto will pay Landec \$2.6 million per year in exchange for (1) a co-exclusive right to use Landec's Intellicoat temperature activated seed coating technology worldwide during the license period, (2) the right to be the exclusive global sales and marketing agent for the Intellicoat seed coating technology, and (3) the right to purchase the technology any time during the five year term of the Agreement. Monsanto will also fund all operating costs, including all Intellicoat research and development, product development and non-replacement capital costs during the five year agreement period. For the fiscal year ended May 27, 2007, Landec recognized \$2.7 million in revenues and income from the Agreement.

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

Technology Licensing/Research and Development Businesses

We believe our technology has commercial potential in a wide range of industrial, consumer and medical applications beyond those identified in our core businesses. For example, our core patented technology, Intelimer materials, can be used to trigger catalysts, insecticides or fragrances just by changing the temperature of the Intelimer materials or to activate adhesives through controlled temperature change. In order to exploit these opportunities, we have entered into and will enter into licensing and collaborative corporate agreements for product development and/or distribution in

certain fields. However, given the infrequency and unpredictability of when the Company may enter into any such licensing and research and development arrangements, the Company is unable to disclose its financial expectations in advance of entering into such arrangements.

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

Intelimer Polymer Systems

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

Personal Care and Cosmetic Applications

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

Medical Applications

On December 23, 2005, Landec entered into an exclusive licensing agreement with Aesthetic Sciences Corporation ("Aesthetic Sciences"). Aesthetic Sciences paid Landec an upfront license fee of \$250,000 for the exclusive rights to use Landec's Intelimer materials technology for the development of dermal fillers worldwide. Landec will also receive royalties on the sale of products incorporating Landec's technology. In addition, the Company has received shares of preferred stock valued at \$1.8 million which represents a 19.9% ownership interest in Aesthetic Sciences. At this time, the Company is unable to predict the ultimate outcome of the collaboration with Aesthetic Sciences and the timing or amount of future revenues, if any.

Sales and Marketing

Each of the Company's core businesses are supported by dedicated sales and marketing resources. The Company intends to develop its internal sales capacity as more products progress toward commercialization and as business volume expands geographically. During fiscal years 2007, 2006 and 2005, sales to the Company's top five customers accounted for approximately 50%, 46% and 42%, respectively, of its revenues, with the top customer, Costco Wholesale Corp., accounting for approximately 21%, 16% and 15%, respectively, of the Company's revenues.

Food Products Technology Business

Apio has 20 sales people, located in central California and throughout the U.S., supporting the export business and the specialty packaged value-added produce business.

Seasonality

The Company's sales are moderately seasonal. Prior to the sale of FCD, Landec Ag revenues and profits were concentrated over a few months during the spring planting season (generally during the Company's third and fourth quarters). In addition, Apio can be heavily affected by seasonal weather factors which have impacted quarterly results, such as high cost of sourcing product in June/July 2006 and January 2007 due to a shortage of essential value-added produce items.

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Manufacturing and Processing

Food Products Technology Business

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

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

Agricultural Seed Technology Business

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

The Company has a pilot manufacturing facility in Indiana to support the commercialization of Early Plant corn and for the Relay Cropping System for wheat/coated soybean products. This facility utilizes a continuous coating process that has increased seed coating capabilities by over tenfold compared to the previous system using batch coaters.

General

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

Research and Development

Landec is focusing its research and development resources on both existing and new applications of its Intelimer technology. Expenditures for research and development for the fiscal years ended May 27, 2007, May 28, 2006 and May 29, 2005 were \$3.1 million, \$3.0 million and \$2.5 million, respectively. Research and development expenditures funded by corporate partners were \$661,000 for the fiscal year ended May 27, 2007, \$100,000 for the fiscal year ended May 28, 2006 and \$20,000 for the fiscal year ended May 29, 2005. The Company may continue to seek funds for applied materials research programs from U.S. government agencies as well as from commercial entities. The Company anticipates that it will continue to have significant research and development expenditures in order to maintain its competitive position with a continuing flow of innovative, high-quality products and services. As of May 27, 2007, Landec had 22 employees engaged in research and development with experience in polymer and analytical chemistry, product application, product formulation, mechanical and chemical engineering.

Competition

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

Patents and Proprietary Rights

The Company's success depends in large part on its ability to obtain patents, maintain trade secret protection and operate without infringing on the proprietary rights of third parties. The Company has had 33 U.S. patents issued of which 27 remain active as of May 27, 2007 with expiration dates ranging from 2010 to 2022. The Company's issued patents include claims relating to compositions, devices and use of a class of temperature sensitive polymers that exhibit distinctive properties of permeability, adhesion and viscosity control. There can be no assurance that any of the pending patent applications will be approved, that the Company will develop additional proprietary products that are patentable, that any patents issued to the Company will provide the Company with competitive advantages or will not be challenged by any third parties or that the patents of others will not prevent the commercialization of products incorporating the Company's technology. Furthermore, there can be no assurance that others will not independently develop similar products, duplicate any of the Company's products or design around the Company's patents. Any of the foregoing results could have a material adverse effect on the Company's business, operating results and financial condition.

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

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

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

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Employees

As of May 27, 2007, Landec had 107 full-time employees, of whom 52 were dedicated to research, development, manufacturing, quality control and regulatory affairs and 55 were dedicated to sales, marketing and administrative activities. Landec intends to recruit additional personnel in connection with the development, manufacturing and marketing of its products. None of Landec's employees is represented by a union, and Landec believes relationships with its employees are good.

Available Information

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

Item 1A. Risk Factors

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

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

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

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

foreign importation restrictions and foreign political risks.

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

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

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

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

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

We Face Strong Competition in the Marketplace

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

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

Any disruptions in our primary manufacturing operation at Apio's facility in Guadalupe, California would reduce our ability to sell our products and would have a material adverse effect on our financial results. Additionally, we may

need to consider seeking collaborative arrangements with other companies to manufacture our products. If we become dependent upon third parties for the manufacture of our products, our profit margins and our ability to develop and deliver those products on a timely basis may be affected. Failures by third parties may impair our ability to deliver products on a timely basis and impair our competitive position. We may not be able to continue to successfully operate our manufacturing operations at acceptable costs, with acceptable yields, and retain adequately trained personnel.

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

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

We May Be Unable to Adequately Protect Our Intellectual Property Rights

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

Our Operations Are Subject to Regulations that Directly Impact Our Business

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

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

Our agricultural operations are subject to a variety of environmental laws including, the Food Quality Protection Act of 1966, the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act, the Federal Insecticide, Fungicide and Rodenticide Act, and the Comprehensive Environmental Response, Compensation and Liability Act. Compliance with these laws and related regulations is an ongoing process. Environmental concerns are,

however, inherent in most agricultural operations, including those we conduct. Moreover, it is possible that future developments, such as increasingly strict environmental laws and enforcement policies could result in increased compliance costs.

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

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

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

We Depend on Strategic Partners and Licenses for Future Development

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

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

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

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

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

criminal prosecution.

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

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

For the fiscal year ended May 27, 2007, approximately 22% of our total revenues were derived from product sales to international customers. A number of risks are inherent in international transactions. International sales and operations may be limited or disrupted by any of the following:

regulatory approval process,

government controls,

export license requirements,

political instability,

price controls,

trade restrictions,

changes in tariffs, or

difficulties in staffing and managing international operations.

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

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

During fiscal year 2007, sales to our top five customers accounted for approximately 50% of our revenues, with our largest customer, Costco Wholesale Corp. accounting for approximately 21% of our revenues. We expect that, for the foreseeable future, a limited number of customers may continue to account for a substantial portion of our net revenues. We may experience changes in the composition of our customer base as we have experienced in the past. We do not have long-term purchase agreements with any of our customers. The reduction, delay or cancellation of orders from one or more major customers for any reason or the loss of one or more of our major customers could materially and adversely affect our business, operating results and financial condition. In addition, since some of the products processed by Apio at its Guadalupe, California facility are sole sourced to its customers, our operating results could be adversely affected if one or more of our major customers were to develop other sources of supply. Our current customers may not continue to place orders, orders by existing customers may be canceled or may not continue at the levels of previous periods or we may not be able to obtain orders from new customers.

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

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

Our Stock Price May Fluctuate in Accordance with Market Conditions

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

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

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

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

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

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

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

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

Our executive officers and directors and their affiliates own or control approximately 17% of our common stock (including options exercisable within 60 days). Accordingly, these officers, directors and shareholders may have the ability to exert significant influence over the election of our Board of Directors, the approval of amendments to our articles and bylaws and the approval of mergers or other business combination transactions requiring shareholder approval. This concentration of ownership may have the effect of delaying or preventing a merger or other business combination transaction, even if the transaction or amendments would be beneficial to our other shareholders. In addition, our controlling shareholders may approve amendments to our articles or bylaws to implement anti-takeover or management friendly provisions that may not be beneficial to our other shareholders.

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

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

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

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

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

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

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

We Have Never Paid any Dividends on Our Common Stock

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

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

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

1B. Unresolved Staff Comments

None.

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Item 2. Properties

As of May 27, 2007, the Company owned or leased properties in Menlo Park, Arroyo Grande and Guadalupe, California; West Lebanon and Oxford Indiana.

These properties are described below:

Location	Business Segment	Ownership	Facilities	Acres of Land	Lease Expiration
Menlo Park, CA	Other	Leased	10,400 square feet of office and laboratory space	—	12/31/09
West Lebanon, IN	Agricultural Seed Technology	Owned	4,000 square feet of warehouse and manufacturing space	—	—
Oxford, IN	Agricultural Seed Technology	Leased	13,400 square feet of laboratory and manufacturing space	—	6/30/08
Guadalupe, CA	Food Products Technology	Owned	142,000 square feet of office space, manufacturing and cold storage	17.7	—
Arroyo Grande, CA	Food Products Technology	Leased	1,100 square feet of office space	—	6/30/08

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

Item 3. Legal Proceedings

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

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

There were no matters submitted to a vote of security holders during the fourth quarter of the Company's fiscal year ended May 27, 2007.

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

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

Fiscal Year Ended May 27, 2007	High	Low
4 th Quarter ending May 27, 2007	\$ 15.13	\$ 12.01
3 rd Quarter ending February 25, 2007	\$ 13.80	\$ 9.49
2 nd Quarter ending November 26, 2006	\$ 11.32	\$ 9.03
1 st Quarter ending August 27, 2006	\$ 11.11	\$ 7.96
Fiscal Year Ended May 28, 2006	High	Low
4 th Quarter ending May 28, 2006	\$ 9.65	\$ 6.71
3 rd Quarter ending February 26, 2006	\$ 7.84	\$ 6.23
2 nd Quarter ending November 27, 2005	\$ 8.01	\$ 6.32
1 st Quarter ending August 28, 2005	\$ 6.98	\$ 6.66

Holders

There were approximately 80 holders of record of 25,904,212 shares of outstanding Common Stock as of July 13, 2007. Since certain holders are listed under their brokerage firm's names, the actual number of shareholders is higher.

Dividends

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

Issuer Purchases of Equity Securities

There were no shares repurchased by the Company during the quarter ending on May 27, 2007.

Item 6. Selected Financial Data

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

	Year Ended May 27, 2007	Year Ended May 28, 2006	Year Ended May 29, 2005	Year Ended May 30, 2004	Seven Months Ended May 25, 2003	Seven Months Ended June 2, 2002 (unaudited)	Year Ended October 27, 2002
Statement of Operations Data: (in thousands)							
Revenues:							
Product sales	\$ 201,892	\$ 225,404	\$ 201,020	\$ 185,664	\$ 98,689	\$ 96,513	\$ 152,958
Service revenues	3,539	3,725	3,704	5,791	12,784	15,882	26,827
License fees	4,013	2,398	88	88	357	1,274	2,330
R&D and royalty revenues	1,054	426	418	549	429	402	1,040
Total revenues	210,498	231,953	205,230	192,092	112,259	114,071	183,155
Cost of revenue:							
Cost of product sales	175,252	188,904	170,359	158,911	82,339	80,680	131,352
Cost of service revenue	2,860	3,005	2,899	3,390	9,216	12,505	20,463
Total cost of revenue	178,112	191,909	173,258	162,301	91,555	93,185	151,815
Gross profit	32,386	40,044	31,972	29,791	20,704	20,886	31,340
Operating costs and expenses:							
Research and development	3,074	3,042	2,543	3,452	2,118	2,018	3,532
Selling, general and administrative	21,616	27,979	23,412	22,284	15,185	16,293	26,114
Income from sale of FCD	(22,669)	—	—	—	—	—	—
Exit domestic commodity vegetable business	—	—	—	—	1,095	—	—
Total operating costs and expenses	2,021	31,021	25,955	25,736	18,398	18,311	29,646
Operating profit	30,365	9,023	6,017	4,055	2,306	2,575	1,694
Interest income	1,945	633	214	164	144	177	247
Interest expense	(251)	(452)	(414)	(811)	(642)	(1,097)	(1,551)
Minority interest expense	(412)	(529)	(411)	(537)	(235)	(224)	(525)
Other (expense)/income, net	(2)	(24)	(4)	29	218	71	336
Income from continuing operations before taxes	31,645	8,651	5,402	2,900	1,791	1,502	201
Income tax expense	(2,456)	—	—	—	—	—	—

Income from continuing operations	29,189	8,651	5,402	2,900	1,791	1,502	201
Discontinued operations:							
Loss from discontinued operations	—	—	—	—	—	—	—
Loss on disposal of operations	—	—	—	—	—	—	(1,688)
Loss from discontinued operations	—	—	—	—	—	—	(1,688)
Net income (loss)	\$ 29,189	\$ 8,651	\$ 5,402	\$ 2,900	\$ 1,791	\$ 1,502	\$ (1,487)
Net income (loss)	\$ 29,189	\$ 8,651	\$ 5,402	\$ 2,900	\$ 1,791	\$ 1,502	\$ (1,487)
Dividends on preferred stock	—	—	—	(464)	(219)	(202)	(412)
Net income (loss) applicable to common shareholders	\$ 29,189	\$ 8,651	\$ 5,402	\$ 2,436	\$ 1,572	\$ 1,300	\$ (1,899)

	Year Ended May 27, 2007	Year Ended May 28, 2006	Year Ended May 29, 2005	Year Ended May 30, 2004	Seven Months Ended May 25, 2003	Seven Months Ended June 2, 2002 (Unaudited)	Year Ended October 27, 2002
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Statements of Operations Data:
(in thousands, except per share data)

Basic net income (loss) per share:

Continuing operations	\$ 1.16	\$ 0.35	\$ 0.23	\$ 0.11	\$ 0.08	\$ 0.07	\$ (0.01)
Discontinued operations	—	—	—	—	—	—	(0.09)
Basic net income (loss) per share	\$ 1.16	\$ 0.35	\$ 0.23	\$ 0.11	\$ 0.08	\$ 0.07	\$ (0.10)
Diluted net income (loss) per share:							
Continuing operations	\$ 1.07	\$ 0.32	\$ 0.21	\$ 0.12	\$ 0.07	\$ 0.06	\$ (0.01)
Discontinued operations	—	—	—	—	—	—	(0.09)
Diluted net income (loss) per share	\$ 1.07	\$ 0.32	\$ 0.21	\$ 0.12	\$ 0.07	\$ 0.06	\$ (0.10)

Shares used in per share computation:

Basic	25,260	24,553	23,705	21,396	20,948	17,777	18,172
Diluted	26,558	25,657	24,614	23,556	22,626	21,082	18,172

	May 27, 2007	May 28, 2006	May 29, 2005	May 30, 2004	May 25, 2003	October 27, 2002
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Balance Sheet Data:
(in thousands)

Cash and cash equivalents	\$ 62,556	\$ 15,164	\$ 7,426	\$ 4,966	\$ 3,610	\$ 7,813
Total assets	141,368	119,025	100,075	93,007	96,887	107,803
Debt	28	2,018	3,088	8,996	13,494	17,543
Convertible preferred stock	—	—	—	—	5,531	14,461
Accumulated deficit	(19,332)	(41,239)	(49,890)	(55,292)	(57,728)	(59,300)
Total shareholders' equity	\$ 110,228	\$ 85,049	\$ 72,060	\$ 61,549	\$ 57,903	\$ 55,963

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

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

Overview

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

With the acquisition of Apio in 1999 and Landec Ag in 1997, the Company has focused on two core businesses - Food Products Technology and Agricultural Seed Technology. The Food Products Technology segment combines the Company's Intelimer packaging technology with Apio's fresh-cut and whole produce business. Prior to the sale of FCD on December 1, 2006 to ASI, the Agricultural Seed Technology segment integrated the Intellicoat seed coating technology with FCD's direct marketing, telephone sales and distribution capabilities. The Company also operates a Technology Licensing/Research and Development business which develops products to be licensed outside of the Company's core businesses. See "Business - Description of Core Business".

From inception through May 27, 2007, the Company's accumulated deficit was \$19.3 million. The Company may incur additional losses in the future. The amount of future net profits, if any, is uncertain and there can be no assurance that the Company will be able to sustain profitability in future years.

Critical Accounting Policies and Use of Estimates

Use of Estimates

The preparation of the Company's financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances.

Notes and Advances Receivables

Apio has made advances to produce growers for crop and harvesting costs. Typically these advances are paid off within the growing season (less than one year) from harvested crops. Advances not fully paid during the current growing season are converted to interest bearing obligations, evidenced by contracts and notes receivable. These notes receivable and advances are secured by liens on land and/or crops and have terms that range from twelve to sixty months. Notes receivable are periodically reviewed (at least quarterly) for collectibility. A reserve is established for

any note or advance deemed to not be fully collectible based upon an estimate of the crop value or the fair value of the security for the note or advance. If crop prices or the fair value of the underlying security declines, the Company may be unable to fully recoup its note or advance receivable and the estimated losses would rise in the current period, potentially to the extent of the total note or advance receivable.

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Allowance for Doubtful Accounts

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

Inventories

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

Revenue Recognition

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

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

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

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

During the fiscal years ended May 27, 2007, May 28, 2006 and May 29, 2005 \$0, \$638,000, and \$88,000, respectively, of the related deferred revenue was recognized as “recycled” revenue. As of May 27, 2007 and May 28, 2006, deferred revenue associated with the change in accounting principles described above is zero.

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

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Goodwill and Other Intangible Asset Impairment

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

Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS No. 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax assets will not be realized. The Company evaluates quarterly the realizability of its deferred tax assets by assessing the valuation allowance and, if necessary, adjusts the amount of such allowance. The factors used to assess the likelihood of realization include the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. Due to the Company's limited tax basis earnings history, the net deferred tax asset at May 27, 2007 has been fully offset by a valuation allowance.

Stock-Based Compensation

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

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

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard to (i) all stock-based awards issued on or after May 29, 2006 and (ii) any outstanding stock-based awards that were issued but not vested as of May 29, 2006. Accordingly, the Company's consolidated financial statements as of May 28, 2006 and May 29, 2005, and for the fiscal years then-ended, were accounted for under the provisions of APB 25.

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

estimates. In the pro-forma information required under SFAS 123R for periods prior to May 29, 2006, the Company accounted for forfeitures as they occurred.

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Recent Accounting Pronouncements

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company has not determined the impact of the adoption of SFAS 157 on its consolidated financial statements.

Accounting for Uncertainty in Income Taxes

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109* ("FIN No. 48"), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition and defines the criteria that must be met for the benefits of a tax position to be recognized. The provisions of FIN No. 48 will be effective for the Company commencing at the start of fiscal 2008, May 28, 2007. The Company is currently evaluating the impact of adopting FIN No. 48 on its consolidated financial statements, however, the Company does not expect the adoption of FIN No. 48 to have a material impact on the Company's consolidated financial statements.

Results of Operations

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

Revenues (in thousands):

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

Apio Value Added

Apio's value-added revenues consist of revenues generated from the sale of specialty packaged fresh-cut and whole value-added processed vegetable products that are washed and packaged in our proprietary packaging and sold under Apio's Eat Smart brand and various private labels and from service revenues from Apio Cooling LP which is now combined with value-added.

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

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Apio Tech

Apio Tech consists of Apio's packaging technology business using its BreatheWay membrane technology. The first commercial application included in Apio Tech is the banana packaging technology. A large majority of the revenues currently generated by Apio Tech are revenues derived from our banana packaging program with Chiquita.

The increase in Apio Tech revenues for the fiscal year ended May 27, 2007 compared to the same period last year was not material to consolidated Landec revenues.

Apio Trading

Apio trading revenues consist of revenues generated primarily from the purchase and sale of whole commodity fruit and vegetable products to Asia through Apio's export company, Cal-Ex and from the purchase and sale of whole commodity fruit and vegetable products domestically. The export portion of trading revenues for fiscal year 2007 was \$46.4 million or 93% of total trading revenues.

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

Landec Ag

Landec Ag revenues have historically consisted of revenues generated from the sale of hybrid seed corn to farmers under the Fielder's Choice Direct brand and from the sale of hybrid seed corn and soybeans under the Heartland Hybrids® brand (these brands, collectively FCD, and the related assets were sold to ASI on December 1, 2006, see Note 2 of Notes to Consolidated Financial Statements) and from the sale of Intellicoat coated corn and soybean seeds to farmers and seed companies. Prior to the sale of FCD, virtually all of Landec Ag's revenues were generated during the Company's third and fourth quarters. As a result of the technology licensing agreement with Monsanto, Landec Ag license fee revenues will be recognized evenly each quarter for a period of five years.

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

Corporate

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

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

Gross Profit (in thousands):

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

General

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

Apio Value-Added

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

Apio Tech

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

Apio Trading

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

Landec Ag

The decrease in gross profit for Landec Ag for the fiscal year ended May 27, 2007 compared to the same periods last year was due to the sale of FCD to ASI and the consequent loss of product sales and gross profit normally recorded during the second half of our fiscal year (see Note 2 of Notes to Consolidated Financial Statements). The decrease in Landec Ag gross profit was partially offset by \$2.7 million of gross profit from the Intellicoat license agreement with Monsanto.

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Corporate

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

Operating Expenses (in thousands):

	<i>Fiscal Year ended May 27, 2007</i>	<i>Fiscal Year ended May 28, 2006</i>	<i>Change</i>
Research and Development:			
Apio	\$ 1,169	\$ 1,108	6%
Landec Ag	266	470	(43%)
Corporate	1,639	1,464	(12%)
Total R&D	\$ 3,074	\$ 3,042	1%
Selling, General and Administrative:			
Apio	\$ 12,667	\$ 13,633	(7%)
Landec Ag	(17,302)	9,616	(280%)
Corporate	3,582	4,730	(24%)
Total S,G&A	\$ (1,053)	\$ 27,979	(104%)

Research and Development

Landec's research and development expenses consist primarily of expenses involved in product development and commercialization initiatives. Research and development efforts at Apio are focused on the Company's proprietary BreatheWay membranes used for packaging produce, with recent focus on extending the shelf life of bananas and other shelf-life sensitive vegetables and fruit. At Landec Ag, the research and development efforts are focused on the Company's proprietary Intellicoat coatings for seeds, primarily corn seed. Beginning December 1, 2006, all of the operating costs and expense of Landec Ag are being paid for by Monsanto in accordance with the technology license and supply agreement (see Note 2 of Notes to Consolidated Financial Statements). At Corporate, the research and development efforts are primarily focused on uses for the proprietary Intelimer polymers outside of food and agriculture.

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

Selling, General and Administrative

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

The decrease in selling, general and administrative expenses for the fiscal year ended May 27, 2007 compared to the same period last year was due to (1) the income realized from the sale of FCD to ASI (see Note 2 of Notes to Consolidated Financial Statements), (2) one-time new packaging design and marketing related costs that were incurred at Apio during the first quarter of fiscal year 2006 and (3) the recording of the net proceeds of \$1.5 million from an insurance settlement (see Note 6 of Notes to Consolidated Financial Statements) to Corporate selling, general and administrative expenses during the first six months of fiscal year 2007.

Other (in thousands):

	<i>Fiscal Year ended May 27, 2007</i>	<i>Fiscal Year ended May 28, 2006</i>	<i>Change</i>
<i>Interest Income</i>	\$ 1,945	\$ 633	207%
<i>Interest Expense</i>	(251)	(452)	(44%)
<i>Minority Interest Expense</i>	(412)	(529)	(22%)
<i>Other Expenses</i>	(2)	(24)	(92%)
<i>Total Other Income (Exp.)</i>	\$ 1,280	\$ (372)	444%