

LANDEC CORP \CA\
Form 10-Q
September 30, 2009

United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Fiscal Quarter Ended August 30, 2009, or

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

For the transition period from _____ to _____.

Commission file number: 0-27446

LANDEC CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

94-3025618
(IRS Employer
Identification Number)

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

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

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

Yes No

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

Yes No

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

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Large Accelerated Filer

Accelerated Filer

Non Accelerated Filer

Smaller Reporting Company

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

Yes No

As of September 21, 2009, there were 26,358,815 shares of Common Stock outstanding.

LANDEC CORPORATION

FORM 10-Q For the Fiscal Quarter Ended August 30, 2009

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	August 30, 2009 (Unaudited)	May 31, 2009 (1)
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 3,998	\$ 43,459
Marketable securities	65,460	22,498
Accounts receivable, less allowance for doubtful accounts of \$204 and \$165 at August 30, 2009 and May 31, 2009, respectively	19,244	15,271
Accounts receivable, related party	484	632
Inventories, net	8,439	5,829
Notes and advances receivable	22	186
Deferred taxes	2,161	2,161
Prepaid expenses and other current assets	908	1,298
Total Current Assets	100,716	91,334
Property and equipment, net	23,325	22,743
Goodwill, net	27,361	27,361
Trademarks, net	8,228	8,228
Other assets	4,032	3,832
Total Assets	\$ 163,662	\$ 153,498
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 19,613	\$ 12,430
Related party accounts payable	384	299
Income taxes payable	278	107
Accrued compensation	1,677	1,112
Other accrued liabilities	1,814	1,805
Deferred revenue	2,702	3,430
Total Current Liabilities	26,468	19,183
Deferred revenue	2,500	3,000
Deferred taxes	4,593	4,119
Total Liabilities	33,561	26,302
Stockholders' Equity:		
Common stock, \$0.001 par value; 50,000,000 shares authorized; 26,358,815 and 26,326,889 shares issued and outstanding at August 30, 2009 and May 31, 2009, respectively	26	26
Additional paid-in capital	116,947	116,158
Retained earnings	11,406	9,222
Total Stockholders' Equity	128,379	125,406
Noncontrolling interest	1,722	1,790
Total Equity	130,101	127,196

Total Liabilities and Stockholders' Equity	\$ 163,662	\$ 153,498
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(1) Derived from audited financial statements.

See accompanying notes.

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

	Three Months Ended	
	August 30, 2009	August 31, 2008
Revenues:		
Product sales	\$ 58,392	\$ 68,861
Services revenue, related party	1,166	1,158
License fees	1,350	1,550
Research, development and royalty revenues	35	184
Total revenues	60,943	71,753
Cost of revenue:		
Cost of product sales	50,106	59,302
Cost of product sales, related party	1,066	1,437
Cost of services revenue	901	891
Total cost of revenue	52,073	61,630
Gross profit	8,870	10,123
Operating costs and expenses:		
Research and development	939	888
Selling, general and administrative	4,570	4,676
Total operating costs and expenses	5,509	5,564
Operating income	3,361	4,559
Interest income	288	357
Interest expense	(1)	(2)
Net income before taxes	3,648	4,914
Income tax expense	(1,282)	(1,911)
Consolidated net income	2,366	3,003
Noncontrolling interest	(182)	(164)
Net income applicable to Common Stockholders	\$ 2,184	\$ 2,839
Basic net income per share	\$ 0.08	\$ 0.11
Diluted net income per share	\$ 0.08	\$ 0.11
Shares used in per share computation		
Basic	26,349	26,163
Diluted	26,716	26,799

See accompanying notes.

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

	Three months Ended	
	August 30, 2009	August 31, 2008
Cash flows from operating activities:		
Net income applicable to Common Stockholders	\$ 2,184	\$ 2,839
Adjustments. to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	762	796
Stock-based compensation expense	220	295
Tax benefit from stock-based compensation expense	(622)	(1,686)
Increase in long-term receivable	(200)	(200)
Deferred taxes	474	—
Noncontrolling interest	182	164
Changes in current assets and current liabilities:		
Accounts receivable, net	(3,973)	803
Accounts receivable, related party	148	4
Inventories, net	(2,610)	(852)
Issuance of notes and advances receivable	(23)	(233)
Collection of notes and advances receivable	187	379
Prepaid expenses and other current assets	390	941
Accounts payable	7,183	(930)
Related party accounts payable	85	104
Income taxes payable	793	2,113
Accrued compensation	565	(835)
Other accrued liabilities	(241)	(198)
Deferred revenue	(1,228)	(1,352)
Net cash provided by operating activities	4,276	2,152
Cash flows from investing activities:		
Purchases of property and equipment	(1,344)	(874)
Issuance of notes and advances receivable	—	(1)
Purchase of marketable securities	(54,067)	(7,013)
Proceeds from maturities of marketable securities	11,105	5,400
Net cash used in investing activities	(44,306)	(2,488)
Cash flows from financing activities:		
Taxes paid by Company for stock swaps to cover taxes on RSUs	(53)	—
Tax benefit from stock-based compensation expense	622	1,686
Decrease in other assets	—	1
Net cash provided by financing activities	569	1,687
Net (decrease) increase in cash and cash equivalents	(39,461)	1,351
Cash and cash equivalents at beginning of period	43,459	44,396
Cash and cash equivalents at end of period	\$ 3,998	\$ 45,747
Supplemental schedule of noncash operating activities:		
Income tax expense not payable	\$ 622	\$ 1,686

Long-term receivable from Monsanto for guaranteed termination fee	\$	200	\$	200
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See accompanying notes.

LANDEC CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

Organization

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

Basis of Presentation

The accompanying unaudited consolidated financial statements of Landec have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made which are necessary to present fairly the financial position at August 30, 2009 and the results of operations and cash flows for all periods presented. Although Landec believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in financial statements and related footnotes prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted per the rules and regulations of the Securities and Exchange Commission. The accompanying financial data should be reviewed in conjunction with the audited financial statements and accompanying notes included in Landec's Annual Report on Form 10-K for the fiscal year ended May 31, 2009.

The results of operations for the three months ended August 30, 2009 are not necessarily indicative of the results that may be expected for an entire fiscal year due to some seasonality in Apio's food business, particularly, Apio's Commodity Trading business.

Basis of Consolidation

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

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

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

considered the primary beneficiary and must consolidate the VIE.

Based on the provisions of FIN 46R, the Company has concluded that as a result of the license and supply agreement between Landec and Monsanto Company (see Note 2), Landec Ag is a VIE. The Company has also determined that it is the primary beneficiary of Landec Ag and therefore the accounts of Landec Ag are consolidated with the accounts of the Company.

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Landec Ag exists solely to administer the license and supply agreement between Landec and Monsanto Company. At August 30, 2009 and May 31, 2009, Landec Ag had total tangible net assets of approximately \$400,000 and \$300,000, respectively.

None of Landec's assets serve as collateral for the obligations of Landec Ag, and there is no restriction on the recourse of creditors or beneficial interest holders of Landec Ag to the general credit of Landec.

Use of Estimates

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

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

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

Cash, Cash Equivalents and Marketable Securities

The Company records all highly liquid securities with three months or less from date of purchase to maturity as cash equivalents and consists mainly of certificate of deposits, money market funds and U.S. Treasuries. Short-term marketable securities consist of certificates of deposit (CDs) that are FDIC insured and single A or better rated municipal bonds with original maturities of more than three months at the date of purchase regardless of the maturity date as the Company views its available-for-sale portfolio as available for use in its current operations. The aggregate amount of CDs included in marketable securities at August 30, 2009 and May 31, 2009 was \$5.8 million and \$2.1 million, respectively. The Company classifies all debt securities with readily determined market values as "available for sale" in accordance with Statement of Financial Accounting Standard ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities". The contractual maturities of the Company's marketable securities that are due in less than one year represent \$34.8 million of our marketable securities and those due in one to two years represents the remaining \$30.7 million of our marketable securities as of August 30, 2009. These investments are classified as marketable securities on the consolidated balance sheet as of August 30, 2009 and May 31, 2009 and are carried at fair market value which currently approximates cost. The difference between the fair market value and the cost of the Company's marketable securities as of August 30, 2009 and May 31, 2009 was not significant. As of August 30, 2009, the aggregate fair value of municipal bonds included in marketable securities with continuous unrealized losses for less than twelve months was \$43.8 million. There are no marketable securities as of August 30, 2009 that have continuous unrealized losses for more than twelve months. Unrealized gains and losses are reported as a component of stockholders' equity and were not significant for the three months ended August 30, 2009 and August 31, 2008. The cost of debt securities is adjusted for amortization of premiums and discounts to maturity. This amortization is recorded to interest income. Realized gains and losses on the sale of available-for-sale securities are also recorded to interest income and were not significant for the three months ended August 30, 2009 and August 31, 2008. The cost of securities sold is based on the specific identification method.

Financial Instruments

The Company's financial instruments are primarily composed of marketable debt securities, commercial-term trade payables and grower advances, and notes receivable, as well as long-term notes receivables and debt instruments. For short-term instruments, the historical carrying amount is a reasonable estimate of fair value. Fair values for long-term financial instruments not readily marketable are estimated based upon discounted future cash flows at prevailing market interest rates. Based on these assumptions, management believes the fair market values of the Company's financial instruments are not materially different from their recorded amounts as of August 30, 2009.

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Investment in Non-Public Company

Landec's investment of \$1.8 million in a non-public company is carried at cost and adjusted for impairment losses, if any. Since there is no readily available market value information, Landec periodically reviews this investment to determine if any other than temporary declines in value have occurred based on the financial stability and viability of the company. The company is currently in discussions with several parties to sell the rights to certain proprietary assets, and potential deal terms with more than one party are in late-stage negotiations. The company's goal is to close the sale in calendar 2009. Landec has evaluated its cost method investment for impairment, utilizing a discounted cash flow analysis of the preliminary terms under late-stage discussions with one of the parties. Based on the expectation that the rights to certain proprietary assets of the company will be sold to a third party, Landec has determined there is no impairment of its investment as of August 30, 2009. However, if the currently proposed or similar deal does not close, Landec will need to re-evaluate impairment, with maximum exposure equal to its cost investment.

New Accounting Pronouncements

Recently Adopted Pronouncements

Fair Value Measurements

In September 2006, FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 does not require new fair value measurements but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of information. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. However, on February 12, 2008, the FASB issued FASB Staff Position ("FSP") FAS No. 157-2 which delays the effective date for all non-financial assets and liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP 157-2 defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within the fiscal years for items within the scope of this FSP, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company adopted SFAS No. 157 on May 26, 2008 for financial assets and financial liabilities. It did not have any impact on the Company's results of operations or financial position for the three months ended August 30, 2009. The Company adopted SFAS No. 157 for non-financial assets and liabilities during the current quarter. Adoption of this statement did not have a material impact on the Company's results of operations or financial position.

Noncontrolling Interests

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements." SFAS No. 160 amends Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements" and establishes accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary. This statement requires the reporting of all noncontrolling interests as a separate component of stockholders' equity, the reporting of consolidated net income (loss) as the amount attributable to both the parent and the noncontrolling interests and the separate disclosure of net income (loss) attributable to the parent and to the noncontrolling interests. Changes in a parent's ownership interest while the parent retains its controlling interest will be accounted for as equity transactions and any retained noncontrolling equity investment upon the deconsolidation of a subsidiary will be initially measured at fair value. Other than the reporting requirements described above which require retrospective application, the provisions of SFAS No. 160 are to be applied prospectively. The Company adopted SFAS No. 160 on June 1, 2009. Adoption of this statement did not have a material impact on the Company's results of operations or financial position for the three months ended August 30, 2009, however, as required, presentation of noncontrolling interests has been conformed to the requirements of the standard for all periods presented.

Collaborative Arrangements

In December 2007, the FASB ratified the EITF consensus on EITF Issue No. 07-1, "Accounting for Collaborative Arrangements" that discusses how parties to a collaborative arrangement (which does not establish a legal entity within such arrangement) should account for various activities. The consensus indicates that costs incurred and revenues generated from transactions with third parties (i.e. parties outside of the collaborative arrangement) should be reported by the collaborators on the respective line items in their income statements pursuant to EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal Versus Net as an Agent." Additionally, the consensus provides that income statement characterization of payments between the participants in a collaborative arrangement should be based upon existing authoritative pronouncements; analogy to such pronouncements if not within their scope; or a reasonable, rational, and consistently applied accounting policy election. The Company adopted EITF Issue No. 07-1 on June 1, 2009. The adoption of EITF Issue No. 07-01 did not have any impact on the Company's results of operations or financial position for the three months ended August 30, 2009.

Fair Value Disclosures in Interim Reports

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. This Staff Position amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments at interim reporting periods. This Staff Position is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009 provided FSP No. FAS 115-2 and FAS 124-2 are also early adopted. The Company adopted FSP No. FAS 107-1 on June 1, 2009. The adoption of this FSP did not have any impact on the Company's results of operations or financial position for the three months ended August 30, 2009.

Subsequent Events

In May 2009, the FASB issued Statement No. 165, "Subsequent Events." Statement 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The Company adopted Statement 165 on June 1, 2009. Adoption of this Statement did not impact the Company's consolidated financials other than the required additional disclosures.

Business Combinations

The FASB issued SFAS No. 141R (revised 2007), "Business Combinations" which significantly changes the financial accounting and reporting for business combination transactions. SFAS No. 141R requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction and establishes the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of this standard will, among other things, impact the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration); exclude transaction costs from acquisition accounting; and change accounting practices for acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. The Company adopted SFAS No. 141R on June 1, 2009. Adoptions of this statement did not have an impact on the Company's results of operations or financial position for the three months ended August 30, 2009, however, its provisions will impact future business combinations.

Recently Issued Pronouncements

Variable Interest Entities

In June 2009, the FASB issued Statement No. 167, “Amendments to FASB Interpretation No. 46(R).” Statement 167 amends the evaluation criteria to identify the primary beneficiary of a variable interest entity provided by FASB Interpretation No. 46(R), “Consolidation of Variable Interest Entities—An Interpretation of ARB No. 51”. Additionally, Statement 167 requires ongoing reassessments of whether an enterprise is the primary beneficiary of the variable interest entity. The Company will adopt Statement 167 in fiscal year 2011 and is currently evaluating the impact of its pending adoption on the Company’s consolidated financial statements.

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Accounting Standards Codification

In June 2009, the FASB issued SFAS No. 168, FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles, a replacement of SFAS No. 162 (“Statement 168”). Statement 168 establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with generally accepted accounting principles. Statement 168 explicitly recognizes rules and interpretive releases of the Securities and Exchange Commission (“SEC”) under federal securities laws as authoritative GAAP for SEC registrants. Statement 168 is effective for financial statements issued for fiscal years and interim periods ending after September 15, 2009. The Company will adopt Statement 168 in the second quarter of fiscal year 2010.

Fair Value Measurements

The Company adopted Statement No. 157 on May 26, 2008 for financial assets and liabilities. The Company also adopted Statement 159 in which entities are permitted to choose to measure many financial instruments and certain other items at fair value. The Company did not elect the fair value option for any of its eligible financial assets or liabilities under SFAS 159.

SFAS No. 157 established a three-tier hierarchy for fair value measurements, which prioritizes the inputs used in measuring fair value as follows:

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

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

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

As of August 30, 2009, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company’s cash equivalents and marketable securities for which the fair value is determined based on observable inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized its cash equivalents and marketable securities as Level 1. The Company has no other financial assets or liabilities for which fair value measurement has been adopted.

Reclassifications

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

2. License Agreement with Monsanto Company

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

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

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

For each of the three months ended August 30, 2009 and August 31, 2008, Landec recognized \$1.35 million in revenues from the Agreement.

If Monsanto exercises its purchase option, Landec and Monsanto will enter into a new long-term supply agreement in which Landec would continue to be the exclusive supplier of Intellicoat polymer materials to Monsanto.

3. License Agreements

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

As part of the original agreement with Aesthetic Sciences, Landec was to receive additional shares upon the completion of a specific milestone. In November 2006, that milestone was met and as a result Landec received an additional 800,000 shares of preferred stock valued at \$481,000. The receipt of the additional 800,000 preferred shares did not change Landec’s 19.9% ownership interest in Aesthetic Sciences. The \$481,000 is included in other assets in the accompanying Consolidated Balance Sheet and was recorded as licensing revenue during fiscal year 2007 in the accompanying Consolidated Statements of Operations since Landec has no further obligations under this agreement. During fiscal year 2009, Aesthetic Sciences completed a second preferred stock offering in which Landec did not participate and as a result Landec’s ownership interest in Aesthetic Sciences was 17.3% as of August 30, 2009 and May 31, 2009.

In March 2006, Landec entered into an exclusive license and research and development agreement with Air Products and Chemicals, Inc. (“Air Products”). Landec will provide research and development support to Air Products for three

years with a mutual option for two additional years. The license fees are being recognized as license revenue over a three year period beginning March 2006. In addition, in accordance with the agreement, Landec will receive 40% of the gross profit generated from the sale of products by Air Products occurring after April 1, 2007, that incorporate Landec's Intelimer materials.

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In September 2007, the Company amended its licensing and supply agreement with Chiquita Brands International, Inc. (“Chiquita”). Under the terms of the amendment, the license for bananas was expanded to include additional exclusive fields using Landec’s BreatheWay® packaging technology, and a new exclusive license has been added for the sale and marketing of avocados and mangos using Landec’s BreatheWay packaging technology. In exchange for expanding the exclusive fields for bananas and adding a new exclusive field for avocados and mango, the minimum gross profits to be received by Landec from the sale of BreatheWay packaging to Chiquita for bananas, avocados and mangos was increased to \$2.2 million in fiscal year 2009. In addition, the minimum gross profits the Company is to receive are calculated and payable on a calendar quarter basis per the terms of the amended agreement. Accordingly, the minimum amounts under the amended agreement will be calculated each calendar quarter and thus will be due at the end of March, June, September and December of each year.

4. Stock-Based Compensation

In the three months ended August 30, 2009, the Company recognized stock-based compensation expense of \$220,000 or \$0.01 per basic and diluted share, which included \$119,000 for restricted stock unit awards and \$101,000 for stock option grants. In the three months ended August 31, 2008, the Company recognized stock-based compensation expense of \$295,000 or \$0.01 per basic and diluted share, which included \$79,000 for restricted stock unit awards and \$216,000 for stock option grants.

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

	Three Months Ended August 30, 2009	Three Months Ended August 31, 2008
Research and development	\$ 49,000	\$ 42,000
Sales, general and administrative	171,000	253,000
Total stock-based compensation	\$ 220,000	\$ 295,000

As of August 30, 2009, there was \$1.5 million of total unrecognized compensation expense related to unvested equity compensation awards granted under the Landec incentive stock plans. Total expense is expected to be recognized over the weighted-average period of 2.66 years for stock options and 2.24 years for restricted stock unit awards.

During the three months ended August 30, 2009, the Company granted options to purchase 47,500 shares of common stock and 15,833 restricted stock unit awards.

As of August 30, 2009 the Company has reserved 2.1 million shares of Common Stock for future issuance under its current and former equity plans.

5. Net Income Per Diluted Share

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

	Three Months Ended August 30, 2009	Three Months Ended August 31, 2008
Numerator:		
Net income applicable to Common Stockholders	\$ 2,184	\$ 2,839
Denominator:		
Weighted average shares for basic net income per share	26,349	26,163

Effect of dilutive securities:

Stock options and restricted stock units	367	636
Weighted average shares for diluted net income per share	26,716	26,799
Diluted net income per share	\$ 0.08	\$ 0.11

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For the three months ended August 30, 2009 and August 31, 2008, the computation of the diluted net income per share excludes the impact of options to purchase 881,613 shares and 245,579 shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

6. **Income Taxes**

The estimated annual effective tax rate for fiscal 2010 is currently expected to be approximately 37%. The provision for income taxes for the three months ended August 30, 2009 was \$1.3 million.

On September 30, 2008, California enacted Assembly Bill 1452 which among other provisions, suspends net operating loss deductions for 2008 and 2009 and extends the carry forward period of any net operating losses not utilized due to such suspension; adopts the federal 20-year net operating loss carry forward period; phases-in the federal two-year net operating loss carryback periods beginning in 2011 and limits the utilization of tax credits to 50 percent of a taxpayer's taxable income. The Company does not expect this change in tax law to materially impact its tax provision, except for the increase in the current state tax liability due to the temporary suspension of the utilization of California net operating loss carry forwards.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("FAS 109"). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

As of May 31, 2009, the Company had unrecognized tax benefits of approximately \$619,000. Included in the balance of unrecognized tax benefits as of May 31, 2009 is approximately \$549,000 of tax benefits that, if recognized, would result in an adjustment to the Company's effective tax rate. The Company does not expect that the amounts of unrecognized tax benefits will change significantly within the next twelve months.

In accordance with FIN 48, paragraph 19, the Company has decided to classify interest and penalties related to uncertain tax positions as a component of its provision for income taxes. Due to the Company's historical taxable loss position, the Company did not accrue interest and penalties relating to the income tax on the unrecognized tax benefits as of August 30, 2009 and May 31, 2009 as the amounts were not significant.

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

7. **Goodwill and Other Intangibles**

The Company tests goodwill and all its other intangible assets with indefinite lives (collectively, "intangible assets") for impairment at least annually, in accordance with the provisions of SFAS No. 142, Goodwill and Other Intangible Assets ("SFAS 142"). When evaluating goodwill for impairment, SFAS 142 requires the Company to first compare the fair value of the reporting unit to its carrying value to determine if there is an impairment loss. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not impaired. Application of the second step of the two-step approach in SFAS 142 is not required. Application of the goodwill impairment tests require significant judgment by management, including identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, determination of the fair value of each reporting unit and projections of future net cash flows, which judgments and projections are inherently uncertain.

The Company considers the results generated from using both of the approaches set forth in SFAS 142 to estimate the fair value of each relevant reporting unit as follows:

- The Company uses the market approach to develop indications of fair value. This approach uses market values and revenue multiples of other publicly-traded companies engaged in the same or similar lines of business as the Company.

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- The Company uses the discounted cash flow (“DCF”) methodology to develop an additional estimate of fair value. The DCF methodology recognizes that current value is premised on the expected receipt of future economic benefits. Indications of value are developed by discounting projected future net cash flows to their present value at a rate that reflects both the current return requirements of the market and the risks inherent in the specific investment.

The determination of whether the intangible assets are impaired involves numerous assumptions, estimates and the application of significant judgment. For the market approach, considerable judgment is required to select comparable companies and estimate the multiples of revenues implied by their market values. For the DCF approach, the Company must exercise judgment in selecting an appropriate discount rate and must also make numerous assumptions in order to develop future business and financial forecasts and the related estimates of future net cash flows. Future net cash flows depend primarily on future product sales, which are inherently difficult to predict.

The Company tested its goodwill and other intangible assets with indefinite lives for impairment as of July 26, 2009 and determined that no adjustments to the carrying values of the intangible assets were necessary as of that date. On a quarterly basis, the Company considers the need to update its most recent annual tests for possible impairment of its intangible assets with indefinite lives, based on management’s assessment of changes in its business and other economic factors since the most recent annual evaluation. Such changes, if significant or material, could indicate a need to update the most recent annual tests for impairment of the intangible assets during the current period. The results of these tests could lead to write-downs of the carrying values of the intangible assets in the current period. No such significant or material changes in the Company’s business or economic environment have come to the attention of management since May 31, 2009 through the date of this report.

8. Inventories

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

	August 30, 2009	May 31, 2009
Finished goods	\$ 4,410	\$ 2,108
Raw material	4,029	3,721
Total	\$ 8,439	\$ 5,829

9. Related Party

Apio provides cooling and distributing services for farms in which the Chairman of Apio (the “Apio Chairman”) has a financial interest and purchases produce from those farms. Apio also purchases produce from Beachside Produce LLC for sale to third parties. Beachside Produce is owned by a group of entities and persons, including the Apio Chairman. Revenues and the resulting accounts receivable and cost of product sales and the resulting accounts payable are classified as related party items in the accompanying financial statements as of August 30, 2009 and May 31, 2009 and for the three months ended August 30, 2009 and August 31, 2008.

Apio leases, for approximately \$310,000 on a current annual basis, agricultural land that is owned by the Apio Chairman. Apio, in turn, subleases that land at cost to growers who are obligated to deliver product from that land to Apio for value added products. There is generally no net statement of income impact to Apio as a result of these leasing activities but Apio creates a guaranteed source of supply for the value added business. Apio has loss exposure on the leasing activity to the extent that it is unable to sublease the land. For the three months ended August 30, 2009, the Company subleased all of the land leased from the Apio Chairman and received sublease income of \$78,000

which is equal to the amount the Company paid to lease that land for the period.

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Apio's domestic commodity vegetable business was sold to Beachside Produce in 2003. The Apio Chairman is a 12.5% owner in Beachside Produce. During the three months ended August 30, 2009 and August 31, 2008, the Company recognized revenues of \$210,000 and \$400,000, respectively, from the sale of products to Beachside Produce. The related accounts receivable from Beachside Produce are classified as related party in the accompanying financial statements as of August 30, 2009 and May 31, 2009.

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

10. Comprehensive Income

The comprehensive income of Landec is insignificantly different from net income.

11. Stockholders' Equity

During the three months ended August 30, 2009, 31,926 shares of Common Stock were issued upon the vesting of restricted stock units and upon the exercise of options under the Company's equity plans.

12. Business Segment Reporting

Landec operates in three business segments: the Food Products Technology segment, the Commodity Trading segment and the Technology Licensing segment. The Food Products Technology segment markets and packs specialty packaged whole and fresh-cut vegetables that incorporate the BreatheWay specialty packaging for the retail grocery, club store and food services industry. In addition, the Food Products Technology segment sells BreatheWay packaging to partners for non-vegetable products. The Commodity Trading segment consists of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia and domestically to Wal-Mart. The Technology Licensing segment licenses Landec's patented Intellicoat seed coatings to the farming industry and licenses the Company's Intelimer polymers for personal care products and other industrial products. Corporate includes corporate general and administrative expenses, non Food Products Technology interest income and Company-wide income tax expenses. All of the assets of the Company are located within the United States of America. The Company's international sales are primarily to Canada, Taiwan, Indonesia, and Japan. Operations by business segment consisted of the following (in thousands):

Three Months Ended August 30, 2009	Food Products		Technology		TOTAL
	Technology	Trading	Licensing	Corporate	
Net sales	\$ 41,856	\$ 17,702	\$ 1,385	\$ —	\$ 60,943
International sales	\$ 3,436	\$ 15,950	\$ —	\$ —	\$ 19,386
Gross profit	\$ 6,381	\$ 1,104	\$ 1,385	\$ —	\$ 8,870
Net income (loss)	\$ 3,398	\$ 578	\$ 740	\$ (2,532)	\$ 2,184
Depreciation and amortization	\$ 716	\$ 3	\$ 43	\$ —	\$ 762
Interest income	\$ 32	\$ —	\$ —	\$ 256	\$ 288
Interest expense	\$ 1	\$ —	\$ —	\$ —	\$ 1
Income tax expense	\$ —	\$ —	\$ —	\$ 1,282	\$ 1,282

Three Months Ended August 31, 2008

Net sales	\$ 43,814	\$ 26,297	\$ 1,642	\$ —	\$ 71,753
International sales	\$ 4,147	\$ 21,693	\$ —	\$ —	\$ 25,840
Gross profit	\$ 7,283	\$ 1,198	\$ 1,642	\$ —	\$ 10,123
Net income (loss)	\$ 3,989	\$ 598	\$ 1,105	\$ (2,853)	\$ 2,839

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Depreciation and amortization	\$	744	\$	4	\$	48	\$	—	\$	796
Interest income	\$	122	\$	—	\$	—	\$	235	\$	357
Interest expense	\$	2	\$	—	\$	—	\$	—	\$	2
Income tax expense	\$	—	\$	—	\$	—	\$	1,911	\$	1,911

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During the three months ended August 30, 2009 and August 31, 2008, sales to the Company's top five customers accounted for 50% and 49%, respectively, of revenues with the Company's top customer from the Food Products Technology segment, Costco Wholesale Corp., accounting for 19% for both of the three months ended August 30, 2009 and August 31, 2008. The Company expects that, for the foreseeable future, a limited number of customers may continue to account for a significant portion of its net revenues.

13. Subsequent Events

The Company evaluated subsequent events in accordance with SFAS No. 165 "Subsequent Events" through the financials statements filing date of September 30, 2009.

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

The following discussion should be read in conjunction with the unaudited consolidated financial statements and accompanying notes included in Part I—Item 1 of this Form 10-Q and the audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in Landec's Annual Report on Form 10-K for the fiscal year ended May 31, 2009.

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Potential risks and uncertainties include, without limitation, those mentioned in this Form 10-Q and, in particular the factors described below in Part II-Item 1A of the Form 10-Q and those mentioned in Landec's Annual Report on Form 10-K for the fiscal year ended May 31, 2009. Landec undertakes no obligation to update or revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this report.

Critical Accounting Policies and Use of Estimates

There have been no material changes to the Company's critical accounting policies which are included and described in the Form 10-K for the fiscal year ended May 31, 2009 filed with the Securities and Exchange Commission on August 4, 2009.

The Company

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

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

Following the sale of Landec's former direct marketing and sales seed corn company, FCD, to Monsanto in fiscal year 2007, Landec now has three core businesses – Food Products Technology, Commodity Trading and Technology Licensing (see note 12 of the unaudited financial statements).

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

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

Our Technology Licensing business includes our proprietary Intellicoat seed coating technology which we have licensed to Monsanto and our Intelimer polymer business that licenses and/or supplies products outside of our Food Products Technology business to companies such as Air Products and Chemicals, Inc. ("Air Products") and Nitta Corporation ("Nitta").

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

Description of Core Business

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

Food Products Technology Business

The Company began marketing its proprietary Intelimer-based BreatheWay® membranes in 1996 for use in the fresh-cut produce packaging market, one of the fastest growing segments in the produce industry. Landec’s proprietary BreatheWay packaging technology when combined with fresh-cut or whole produce results in packaged produce with increased shelf life and reduced shrink (waste) without the need for ice during 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. During the fiscal year ended May 31, 2009, Apio shipped nearly sixteen 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 four major distinguishing characteristics of Apio that provide competitive advantages in the Food Products Technology market:

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

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

Lower Cost Structure: Apio has strategically invested in the rapidly growing fresh-cut and whole value-added business. Apio’s 96,000 square foot value-added processing plant is automated with state-of-the-art vegetable processing equipment. Virtually all of Apio’s value-added products utilize Apio’s proprietary BreatheWay packaging technology. Apio’s strategy is to operate one large central processing facility in one of California’s largest, lowest cost growing regions (Santa Maria Valley) and use packaging technology to allow for the nationwide delivery of fresh produce products.

Expanded Product Line Using Technology: Apio, through the use of its BreatheWay packaging technology, is introducing on average fifteen new value-added products each year. These new product offerings range from various sizes of fresh-cut bagged products, to vegetable trays, to whole produce, to vegetable salads and snack packs. During the last twelve months, Apio has introduced 13 new products.

Apio established its Apio Packaging division in 2005 to advance the sales of BreatheWay packaging technology for shelf-life sensitive vegetables and fruit.

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

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

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

In fiscal year 2008, the Company expanded the use of its BreatheWay technology to avocados under an expanded licensing agreement with Chiquita. Commercial sales of avocados packaged in Landec's BreatheWay packaging into the food service industry began late in fiscal year 2008 and market trials are currently underway for retail applications.

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

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

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

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

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

Commodity Trading Business

Commodity Trading revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia through Apio's export company, Cal-Ex, and from the purchase and sale of whole commodity fruit and vegetable products domestically to Wal-Mart. The Commodity Trading business is a buy/sell business that realizes a commission-based margin on average in the 5-6% range.

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Technology Licensing Businesses

The Technology and Market Opportunity: Intellicoat Seed Coatings

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

Landec's Intellicoat seed coating applications are designed to control seed germination timing, increase crop yields, reduce risks and extend crop-planting windows. These coatings are currently available on hybrid corn, soybeans and male inbred corn used for seed production. In fiscal year 2000, Landec Ag launched its first commercial product, Pollinator Plus® coatings, which is a coating application used by seed companies as a method for spreading pollination to increase yields and reduce risk in the production of hybrid seed corn. There are approximately 650,000 acres of seed production in the United States and in 2009 Pollinator Plus was used by 18 seed companies on approximately 22% of the seed corn production acres in the U.S.

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

The Technology and Market Opportunity: Intelimer Polymer Applications

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

Industrial Materials and Adhesives

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

Intelimer Polymer Systems

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

latent catalysts and personal care technologies were licensed to Air Products in March 2006.

Personal Care and Cosmetic Applications

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

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Medical Applications

In December 2005, Landec entered into an exclusive licensing agreement with Aesthetic Sciences Corporation (“Aesthetic Sciences”). Aesthetic Sciences paid Landec an upfront license fee of \$250,000 for the exclusive rights to use Landec's Intelimer materials technology for the development of dermal fillers worldwide. Landec will also receive royalties on the sale of products incorporating Landec’s technology. In addition, the Company has received shares of preferred stock valued at \$1.8 million which as of May 31, 2009 represented a 17.3% 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.

Results of Operations

Revenues (in thousands):

	Three months ended 8/30/09	Three months ended 8/31/08	Change
Apio Value Added	\$ 41,292	\$ 43,002	(4)%
Apio Packaging	564	812	(31)%
Apio Tech. Subtotal	41,856	43,814	(4)%
Commodity Trading	17,702	26,297	(33)%
Total Apio	59,558	70,111	(15)%
Tech. Licensing	1,385	1,642	(16)%
Total Revenues	\$ 60,943	\$ 71,753	(15)%

Apio Value Added

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

The decrease in Apio’s value-added revenues for the three months ended August 30, 2009 compared to the first quarter of last year was primarily due to the fact that the first quarter of fiscal year 2009 included 14 weeks of revenue compared to 13 weeks during the first quarter of fiscal year 2010.

Apio Packaging

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

The decrease in Apio packaging revenues for the three months ended August 30, 2009 compared to the same period last year was primarily due to the reduction in contractual minimum payments received from Chiquita under the amended Chiquita license agreement.

Commodity Trading

Apiro trading revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia by Cal-Ex and from the purchase and sale of whole commodity fruit and vegetable products domestically to Wal-Mart. The export portion of trading revenues for the first quarter of fiscal year 2010 was \$16.0 million or 90% of total trading revenues.

The decrease in revenues in Apio's trading business for the three months ended August 30, 2009 compared to the same period last year was due to a 26% decrease in export sales volumes as a result of a decreased supply of produce to export, primarily fruit, and a \$2.9 million decrease in domestic commodity sales to Wal-Mart due to the planned exiting of most of our domestic buy/sell business with Wal-Mart. In addition, the first quarter of fiscal year 2009 included 14 weeks of revenue compared to 13 weeks during the first quarter of fiscal year 2010.

Technology Licensing

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

The decrease in Technology Licensing revenues for the three months ended August 30, 2009 compared to the same period of the prior year was not significant to consolidated Landec revenues.

Gross Profit (in thousands):

	Three months ended 8/30/09	Three months ended 8/31/08	Change
Apio Value Added	\$ 5,865	\$ 6,580	(11)%
Apio Packaging	516	703	(27)%
Apio Tech. Subtotal	6,381	7,283	(12)%
Commodity Trading	1,104	1,198	(8)%
Total Apio	7,485	8,481	(12)%
Tech. Licensing	1,385	1,642	(16)%
Total Gross Profit	\$ 8,870	\$ 10,123	(12)%

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 the costs related to the sale of products in accordance with generally accepted accounting principles. These costs include the following: raw materials (including produce 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 first quarter of fiscal year 2010 compared to the same period last year as outlined in the table above.

Apio Value-Added

The decrease in gross profit for Apio's value-added specialty packaged vegetable business for the three months ended August 30, 2009 compared to the same period last year was primarily due to the decrease in revenues of 4% during the first quarter of fiscal year 2010 compared to the first quarter of last year coupled with an increase in the cost of produce during this year's first quarter compared to last year's first quarter. In addition, the first quarter of fiscal year 2009 included 14 weeks of gross profit compared to 13 weeks during the first quarter of fiscal year 2010.

Apio Packaging

The decrease in gross profit for Apio Packaging for the three months ended August 30, 2009 compared to the same period last year was primarily due to the reduction of contractual minimum payments received from Chiquita under the amended Chiquita license agreement.

Commodity Trading

Apio's commodity trading business is a buy/sell business that realizes a commission-based margin in the 5-6% range. The decrease in gross profit for Apio's commodity trading business during the three months ended August 30, 2009 compared to the same period last year was primarily due to a 33% decrease in revenues. In addition, the first quarter of fiscal year 2009 included 14 weeks of gross profit compared to 13 weeks during the first quarter of fiscal year 2010. The decrease in revenues was greater than the decrease in gross profit because the decrease in revenues was primarily due to decreased domestic commodity volume sales which is a 2% margin business and decreased export of fruit which realizes lower gross margins than the gross margins realized from the export of vegetables.

Technology Licensing

The decrease in Technology Licensing gross profit for the three months ended August 30, 2009 compared to the same period of the prior year was not significant to consolidated Landec gross profit.

Operating Expenses (in thousands):

	Three months ended 8/30/09	Three months ended 8/31/08	Change
Research and Development:			
Apio	\$ 294	\$ 351	(16)%
Tech. Licensing	645	537	20%
Total R&D	\$ 939	\$ 888	6%
Selling, General and Administrative:			
Apio	\$ 3,063	\$ 3,500	(12)%
Corporate	1,507	1,176	28%
Total S,G&A	\$ 4,570	\$ 4,676	(2)%

Research and Development

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

The increase in research and development expenses for the three months ended August 30, 2009 compared to the same period last year was not significant.

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 three months ended August 30, 2009 compared to the same period last year was not significant.

Other (in thousands):

	Three months ended 8/30/09	Three months ended 8/31/08	Change
Interest Income	\$ 288	\$ 357	(19)%
Interest Expense	\$ (1)	\$ (2)	(50)%

Income Taxes	\$	1,282	\$	1,911	33%
Noncontrolling interest	\$	182	\$	164	11%

Interest Income

The decrease in interest income for the three months ended August 30, 2009 compared to the same period last year was primarily due to lower yields on investments due to declines in interest rates.

Interest Expense

The decrease in interest expense during the three months ended August 30, 2009 compared to the same period last year was not significant.

Income Taxes

The decrease in the income tax expense is due to a 26% decrease in net income before taxes during the three months ended August 30, 2009 compared to the same period last year and a decrease in the Company's effective tax rate, after taking into account the expense for noncontrolling interest, to 37% for the three months ended August 30, 2009 compared to 40% for the same period last year.

Noncontrolling Interest

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

The increase in the noncontrolling interest for the three months ended August 30, 2009 compared to the first quarter of last year was not significant.

Liquidity and Capital Resources

As of August 30, 2009, the Company had cash and cash equivalents of \$4.0 million, a net decrease of \$39.5 million from \$43.5 million at May 31, 2009.

Cash Flow from Operating Activities

Landec generated \$4.3 million of cash flow from operating activities during the three months ended August 30, 2009 compared to generating \$2.2 million of cash flow from operating activities for the three months ended August 31, 2008. The primary sources of cash from operating activities during the three months ended August 30, 2009 were from (1) generating \$2.2 million of net income, (2) non-cash related net expenses of \$816,000 and (3) a net increase of \$1.3 million in working capital. The primary changes in working capital were (a) a \$4.0 million increase in accounts receivable due to August 2009 revenues being considerably higher than May 2009 revenues, (b) a \$2.6 million increase in inventories resulting from the timing of receipts and the build up of inventories in advance of the holiday season, (c) a \$7.2 million increase in accounts payable resulting from the timing of payments and the increase in cost of sales due to August 2009 cost of sales being higher than May 2009 cost of sales, and (d) a \$1.2 million decrease in deferred revenue primarily due to recognizing \$1.4 million of revenue associated with deferred revenue from the Monsanto licensing agreement during the first three months of fiscal year 2010.

Cash Flow from Investing Activities

Net cash used in investing activities for the three months ended August 30, 2009 was \$44.3 million compared to \$2.5 million for the same period last year. The primary uses of cash in investing activities during the first quarter of fiscal year 2010 were for the purchase of \$1.3 million of property, plant and equipment primarily for the further expansion of Apio's value-added processing facility and the further automation of Apio's value-added processing facility and from the net purchase of \$43.0 million of marketable securities.

Cash Flow from Financing Activities

Net cash provided by financing activities for the three months ended August 30, 2009 was \$569,000 compared to \$1.7 million for the same period last year. The source of cash from financing activities during the first quarter of fiscal year 2010 was the tax benefit from stock-based compensation of \$622,000.

Capital Expenditures

During the three months ended August 30, 2009, Landec started the expansion of Apio's value-added processing facility and purchased vegetable processing equipment to support the further automation of Apio's value added processing facility. These expenditures represented the majority of the \$1.3 million of capital expenditures.

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

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

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

None.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting during the quarter ended August 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

The risk factors set forth below include and material changes to, and supersede the descriptions of, the risk factors disclosed in Item 1A of the Company's Form 10-K for the year ended May 31, 2009.

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 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.

The United States' Economy is Currently Undergoing a Period of Slowdown and Unprecedented Volatility, Which May Have an Adverse Effect on Our Business

The U.S. and international economy and financial markets have experienced significant slowdown and volatility due to uncertainties related to the availability of credit, energy prices, difficulties in the banking and financial services sectors, softness in the housing market, severely diminished market liquidity, geopolitical conflicts, falling consumer confidence and rising unemployment rates. This slowdown has and could further lead to reduced demand for our products, which in turn, would reduce our revenues and adversely affect our business, financial condition and results of operations. In particular, the slowdown and volatility in the global markets have resulted in softer demand and more conservative purchasing decisions by customers, including a tendency toward lower-priced products, which could negatively impact our revenues, gross margins and results of operations. In addition to a reduction in sales, our profitability may decrease during downturns because we may not be able to reduce costs at the same rate as our sales decline. These slowdowns are expected to worsen if current economic conditions are prolonged or deteriorate further. We cannot predict the ultimate severity or length of the current economic crisis, or the timing or severity of future economic or industry downturns.

Given the current unfavorable economic environment, our customers may have difficulties obtaining capital at adequate or historical levels to finance their ongoing business and operations, which could impair their ability to make timely payments to us. This may result in lower sales and/or additional inventory or bad debt expense for Landec. In addition to the impact of the economic downturn on our customers, some of our vendors and growers may experience a reduction in their availability of funds and cash flows, which could negatively impact their business as well as ours. A continuing or deepening downturn of the U.S. economy, including increased volatility in the credit markets, could adversely impact our customers' and vendors' ability or willingness to conduct business with us on the same terms or at the same levels as they have historically.

We are unable to predict the likely duration and severity of the current disruption in the financial markets and adverse economic conditions in the U.S. and other countries and such conditions, if they persist or worsen, will further adversely impact our business, operating results, and financial condition. Further, these conditions and uncertainty about future economic conditions make it challenging for Landec to forecast its operating results, make business

decisions, and identify the risks that may affect its business, sources and use of cash, financial condition and results of operations.

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

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

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

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

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

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

- price;
- safety;
- efficacy;
- reliability;
- conversion costs;
- marketing and sales efforts; and

general economic conditions affecting purchasing patterns.

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

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We Face Strong Competition in the Marketplace

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

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

Any disruptions in our primary manufacturing operation at Apio's facility in Guadalupe, California would reduce our ability to sell our products and would have a material adverse effect on our financial results. Additionally, we may need to consider seeking collaborative arrangements with other companies to manufacture our products. If we become dependent upon third parties for the manufacture of our products, our profit margins and our ability to develop and deliver those products on a timely basis may be affected. Failures by third parties may impair our ability to deliver products on a timely basis and impair our competitive position. We may not be able to continue to successfully operate our manufacturing operations at acceptable costs, with acceptable yields, and retain adequately trained personnel.

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

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

We May Be Unable to Adequately Protect Our Intellectual Property Rights

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

Our Operations Are Subject to Regulations that Directly Impact Our Business

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

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

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

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

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

Our Food Products Technology 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:

finances, 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 three months ended August 30, 2009, approximately 32% of our total revenues were derived from product sales to international customers. A number of risks are inherent in international transactions. International sales and operations may be limited or disrupted by any of the following:

regulatory approval process,

government controls,

export license requirements,

political instability,

price controls,

trade restrictions,

changes in tariffs, or

difficulties in staffing and managing international operations.

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

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

During the three months ended August 30, 2009, sales to our top five customers accounted for approximately 50% of our revenues, with our largest customer, Costco Wholesale Corporation, accounting for approximately 19% 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.

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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.

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 stockholders, to fix the rights and preferences, and to issue shares, of preferred stock. In November 1999, we issued and sold shares of Series A Convertible Preferred Stock and in October 2001 we issued and sold shares of Series B Convertible Preferred Stock. The Series A Convertible Preferred Stock was converted into 1,666,670 shares of Common Stock in November 2002 and the Series B Convertible Preferred Stock was converted into 1,744,102 shares of Common Stock in May 2004.

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

We Have Never Paid any Dividends on Our Common Stock

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

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

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

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

None

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit
Number Exhibit Title:

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- 31.1+ CEO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2+ CFO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1+ CEO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2+ CFO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
+ Filed herewith.

