

# LANDEC CORP \CA\

## FORM 10-Q (Quarterly Report)

Filed 09/29/06 for the Period Ending 08/27/06

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Symbol LNDC  
SIC Code 2821 - Plastics Materials, Synthetic Resins, and Nonvulcanizable Elastomers  
Industry Chemicals - Plastics & Rubber  
Sector Basic Materials  
Fiscal Year 05/29

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

**FORM 10-Q**

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

For the Fiscal Quarter Ended August 27, 2006 , or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: 0-27446

**LANDEC CORPORATION**

(Exact name of registrant as specified in its charter)

**California**

(State or other jurisdiction of  
incorporation or organization)

**94-3025618**

(IRS Employer  
Identification Number)

**3603 Haven Avenue**

**Menlo Park, California 94025**

(Address of principal executive offices, 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer  Non Accelerated Filer

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

Yes  No

As of September 15, 2006, there were 24,989,192 shares of Common Stock outstanding.

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**LANDEC CORPORATION**

FORM 10-Q For the Fiscal Quarter Ended August 27, 2006

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

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

|  | August 27,<br>2006<br>(Unaudited) | May 28,<br>2006  |
|--|-----------------------------------|------------------|
| <b>ASSETS</b>  |                                   |                  |
| Current Assets:  |                                   |                  |
| Cash and cash equivalents  | \$ 14,363                         | \$ 20,519        |
| Accounts receivable, less allowance for doubtful accounts of \$309 and \$245 at August 27, 2006 and May 28, 2006   | 15,369                            | 17,637           |
| Accounts receivable, related party   | 410                               | 561              |
| Inventory  | 15,997                            | 13,958           |
| Notes and advances receivable  | 223                               | 376              |
| Notes receivable, related party  | —                                 | 14               |
| Prepaid expenses and other current assets  | 1,826                             | 1,637            |
| Total Current Assets   | 48,188                            | 54,702           |
| Property and equipment, net  | 20,504                            | 19,014           |
| Goodwill, net  | 29,507                            | 29,124           |
| Trademarks, net  | 13,270                            | 13,270           |
| Other intangibles, net   | 822                               | 860              |
| Notes receivable   | 631                               | 631              |
| Other assets   | 1,359                             | 1,424            |
| Total Assets   | <u>\$ 114,281</u>                 | <u>\$119,025</u> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                   |                  |
| Current Liabilities:   |                                   |                  |
| Accounts payable   | \$ 22,435                         | \$ 23,435        |
| Related party payables   | 463                               | 533              |
| Accrued compensation   | 1,001                             | 3,303            |
| Other accrued liabilities  | 2,425                             | 2,032            |
| Deferred revenue   | 733                               | 884              |
| Current maturities of long term debt   | 45                                | 2,018            |
| Total Current Liabilities  | 27,102                            | \$ 32,205        |
| Minority interest  | 1,497                             | 1,771            |
| Total Liabilities  | 28,599                            | 33,976           |
| Shareholders' Equity:  |                                   |                  |
| Common stock, \$0.001 par value; 50,000,000 shares authorized; 24,989,192 and 24,917,298 shares issued and outstanding at August 27, 2006 and May 28, 2006, respectively | 126,907                           | 126,288          |
| Accumulated deficit  | (41,225)                          | (41,239)         |
| Total Shareholders' Equity   | 85,682                            | 85,049           |
| Total Liabilities and Shareholders' Equity   | <u>\$ 114,281</u>                 | <u>\$119,025</u> |

*See accompanying notes.*

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

|   | Three Months Ended |                    |
|---|--------------------|--------------------|
|   | August 27,<br>2006 | August 28,<br>2005 |
| <b>Revenues:</b>                              |                    |                    |
| Product sales                                 | \$ 50,046          | \$ 48,327          |
| Services revenue, related party               | 843                | 1,167              |
| License fees                                  | 200                | 122                |
| Royalty revenues, related party               | 50                 | 76                 |
| Research, development and royalty revenues    | 8                  | 13                 |
| <b>Total revenues</b>                         | <u>51,147</u>      | <u>49,705</u>      |
| <b>Cost of revenue:</b>                       |                    |                    |
| Cost of product sales                         | 43,288             | 40,845             |
| Cost of product sales, related party          | 1,549              | 1,663              |
| Cost of services revenue                      | 754                | 607                |
| <b>Total cost of revenue</b>                  | <u>45,591</u>      | <u>43,115</u>      |
| <b>Gross profit</b>                           | 5,556              | 6,590              |
| <b>Operating costs and expenses:</b>          |                    |                    |
| Research and development                      | 784                | 758                |
| Selling, general and administrative           | 4,902              | 6,183              |
| <b>Total operating costs and expenses</b>     | <u>5,686</u>       | <u>6,941</u>       |
| Operating loss                                | (130)              | (351)              |
| Interest income                               | 236                | 120                |
| Interest expense                              | (70)               | (73)               |
| Minority interest expense                     | (18)               | (215)              |
| Other expense                                 | (4)                | (2)                |
| <b>Net income (loss)</b>                      | <u>\$ 14</u>       | <u>\$ (521)</u>    |
| <br>  |                    |                    |
| Basic and diluted net income (loss) per share | <u>\$ 0.00</u>     | <u>\$ (0.02)</u>   |
| <br>  |                    |                    |
| Shares used in per share computation          | <u>24,936</u>      | <u>24,115</u>      |

*See accompanying notes.*

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

|  | Three months Ended |                    |
|--|--------------------|--------------------|
|  | August 27,<br>2006 | August 28,<br>2005 |
| Cash flows from operating activities:  |                    |                    |
| Net income (loss)  | \$ 14              | \$ (521)           |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: |                    |                    |
| Depreciation and amortization  | 886                | 766                |
| Stock-based compensation expense   | 246                | —                  |
| Loss on sale of property and equipment   | 4                  | 6                  |
| Minority interest  | 78                 | 215                |
| Changes in current assets and current liabilities:                                   |                    |                    |
| Accounts receivable, net   | 2,419              | (1,878)            |
| Inventory  | (2,039)            | (994)              |
| Issuance of notes and advances receivable  | —                  | (5)                |
| Collection of notes and advances receivable  | 168                | 127                |
| Prepaid expenses and other current assets  | (189)              | 127                |
| Accounts payable   | (1,000)            | 766                |
| Related party payables   | (70)               | (540)              |
| Accrued compensation   | (2,302)            | (516)              |
| Other accrued liabilities  | 10                 | 321                |
| Deferred revenue   | (151)              | (115)              |
| Net cash used in operating activities  | <u>(1,926)</u>     | <u>(2,241)</u>     |
| Cash flows from investing activities:  |                    |                    |
| Purchases of property and equipment  | (2,342)            | (633)              |
| Purchase of marketable securities  | —                  | (1,018)            |
| Issuance of notes and advances receivable  | (15)               | (10)               |
| Collection of notes and advances receivable  | 14                 | 28                 |
| Net cash used in investing activities  | <u>(2,343)</u>     | <u>(1,633)</u>     |
| Cash flows from financing activities:  |                    |                    |
| Proceeds from sale of common stock   | 373                | 241                |
| Proceeds from the exercise of subsidiary options                                     | 9                  | —                  |
| Decrease in other assets   | 65                 | 156                |
| Borrowings on lines of credit  | —                  | 33                 |
| Payments on lines of credit  | —                  | (33)               |
| Payments on long term debt   | (1,973)            | (971)              |
| Payments to minority interest  | (361)              | —                  |
| Net cash used in financing activities  | <u>(1,887)</u>     | <u>(574)</u>       |
| Net decrease in cash and cash equivalents  | (6,156)            | (4,448)            |
| Cash and cash equivalents at beginning of period                                     | <u>20,519</u>      | <u>12,871</u>      |
| Cash and cash equivalents at end of period   | <u>\$ 14,363</u>   | <u>\$ 8,423</u>    |

*See accompanying notes.*

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

**1. Basis of Presentation**

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

The accompanying unaudited consolidated financial statements of Landec have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made which are necessary to present fairly the financial position at August 27, 2006 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 28, 2006.

The results of operations for the three months ended August 27, 2006 are not necessarily indicative of the results that may be expected for an entire fiscal year. For instance, due to the cyclical nature of the corn seed industry, a significant portion of Landec Ag revenues and profits will be concentrated over a few months during the spring planting season (generally during Landec’s third and fourth fiscal quarters).

**Use of Estimates**

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

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

**Investments**

Equity investments in non-public companies with no readily available market value are carried on the balance sheet at cost as adjusted for impairment losses, if any. If reductions in the market value of the investments to an amount that is below cost are deemed by management to be other than temporary, the reduction in market value will be realized, with the resulting loss in market value reflected on the income statement.

**Recent Accounting Pronouncements**

In June 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109* (“FIN No. 48”), which



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clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition and defines the criteria that must be met for the benefits of a tax position to be recognized. The provisions of FIN No. 48 will be effective for the Company commencing at the start of fiscal 2008, May 28, 2007. The Company is currently evaluating the impact of adopting FIN No. 48 on its consolidated financial statements.

### Reclassifications

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

## 2. Stock-Based Compensation

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

Prior to the adoption of SFAS 123R, the Company applied the intrinsic value method set forth in APB 25 to calculate the compensation expense for stock-based awards. The Company has historically set the exercise price for its stock options equal to the market value on the grant date. As a result, the options had no intrinsic value on their grant dates, and therefore the Company did not record any compensation expense unless the terms of the stock options were subsequently modified. For RSUs, the calculation of compensation expense under APB 25 and SFAS 123R is similar except for the accounting treatment for forfeitures as discussed below. During fiscal year 2006, 833 restricted stock units were granted. No expense was recorded on the RSUs granted in fiscal year 2006 as the expense was not material.

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard to (i) all stock-based awards issued on or after May 29, 2006 and (ii) any outstanding stock-based awards that were issued but not vested as of May 29, 2006. Accordingly, the Company's condensed consolidated financial statements as of August 28, 2005, and for the three months then-ended, do not reflect the requirements of SFAS 123R. In the three months ended August 27, 2006, the Company recognized stock-based compensation expense of \$245,912 or \$0.01 per basic and diluted share, which included \$32,826 for restricted stock unit awards and \$213,086 for stock option grants.

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

|  | <b>Three Months<br/>Ended<br/>August 27, 2006</b> |
|--|---|
| Research and development                       | \$ 19,070   |
| Sales, general and administrative              | \$ 226,842  |
| Total amortization of stock-based compensation | \$ 245,912  |

The estimated fair value for stock options, which determines the Company's calculation of compensation expense, is based on the Black-Scholes pricing model. Upon the adoption of SFAS 123R, the Company changed its method of calculating the value of all stock-based compensation to the straight-line, single-option method. However, compensation expense for all stock option grants and restricted stock awards prior to May 29, 2006, will continue to be recognized using the straight-line, multiple-option method. In addition, SFAS 123R requires that the expected forfeitures of stock-based awards to be estimated at the time of grant. As a result, the Company estimates

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the forfeiture rate for all stock-based compensation at the time of grant and revises those estimates in subsequent periods if the actual forfeitures differ from the prior estimates. The Company uses historical data to estimate pre-vesting forfeitures and records stock-based compensation expense only for those awards that are expected to vest. In the pro-forma information required under SFAS 123 for periods prior to May 29, 2006, the Company accounted for forfeitures as they occurred.

### Valuation Assumptions

As of August 27, 2006 and August 28, 2005, the fair value of stock option grants was estimated using the Black-Scholes option pricing model. The following weighted average assumptions were used:

|                         | Three Months Ended |                    |
|-------------------------|--------------------|--------------------|
|                         | August 27,<br>2006 | August 28,<br>2005 |
| Stock option plan:      |                    |                    |
| Risk-free interest rate | 5.08%              | 3.49%              |
| Dividend yield          | 0%                 | 0%                 |
| Volatility              | 51%                | 55%                |
| Expected term in years  | 4.27               | 4.16               |

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

|  | August 28,<br>2005 |
|--|--------------------|
| Net loss   | \$ (521)           |
| Deduct:  |                    |
| Stock-based employee expense determined under SFAS 123 | (238)              |
| Pro forma net loss                                     | <u>\$ (759)</u>    |
| Basic and diluted net loss per share – as reported     | <u>\$ (0.02)</u>   |
| Basic and diluted pro forma net loss per share         | <u>\$ (0.03)</u>   |

### Stock-Based Compensation Activity

|                            | Restricted Stock Outstanding                  |                                   |   | Stock Options Outstanding  |                                       |
|----------------------------|---|-----------------------------------|---|----------------------------|---------------------------------------|
|                            | RSUs and<br>Options<br>Available<br>for Grant | Number of<br>Restricted<br>Shares | Weighted<br>Average<br>Grant Date<br>Fair Value | Number of<br>Stock Options | Weighted<br>Average<br>Exercise Price |
| Balance at May 28, 2006    | 857,705                                       | 833                               | \$7.53  | 3,117,516                  | \$4.85                                |
| Granted                    | (153,335)                                     | 38,335                            | \$8.86  | 115,000                    | \$8.86                                |
| Exercised                  | —   | —                                 | —   | (54,146)                   | \$5.22                                |
| Forfeited                  | —   | —                                 | —   | (3,750)                    | \$6.09                                |
| Balance at August 27, 2006 | <u>704,370</u>                                | <u>39,168</u>                     | <u>\$8.83</u>                                   | <u>3,174,620</u>           | <u>\$4.99</u>                         |

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The following table summarizes information concerning stock options outstanding and exercisable at August 27, 2006:

| Range of Exercise Prices | Options Outstanding                        |   |                                 | Options Exercisable       |                              |                                 |                           |
|--------------------------|--|---|---------------------------------|---------------------------|------------------------------|---------------------------------|---------------------------|
|                          | Number of Shares Outstanding<br>(in years) | Weighted Average Contractual Life<br>(in years) | Weighted Average Exercise Price | Aggregate Intrinsic Value | Number of Shares Exercisable | Weighted Average Exercise Price | Aggregate Intrinsic Value |
| \$1.660 – \$3.180        | 460,126                                    | 6.00  | \$ 2.58                         | \$ 3,414,135              | 432,308                      | \$ 2.59                         | \$ 3,203,402              |
| \$3.250 – \$3.400        | 414,850                                    | 4.03  | \$ 3.38                         | \$ 2,746,307              | 411,412                      | \$ 3.38                         | \$ 2,723,547              |
| \$3.470 – \$4.938        | 408,385                                    | 4.31  | \$ 4.30                         | \$ 2,327,795              | 405,259                      | \$ 4.30                         | \$ 2,309,976              |
| \$5.000 – \$5.000        | 735,600                                    | 1.34  | \$ 5.00                         | \$ 3,678,000              | 735,600                      | \$ 5.00                         | \$ 3,678,000              |
| \$5.250 – \$6.130        | 419,159                                    | 5.20  | \$ 6.05                         | \$ 1,655,678              | 307,284                      | \$ 6.03                         | \$ 1,219,917              |
| \$6.250 – \$6.750        | 390,000                                    | 4.97  | \$ 6.66                         | \$ 1,302,600              | 390,000                      | \$ 6.66                         | \$ 1,302,600              |
| \$6.790 – \$7.500        | 224,000                                    | 8.19  | \$ 7.12                         | \$ 645,120                | 224,000                      | \$ 7.12                         | \$ 645,120                |
| \$7.530 – \$8.860        | 122,500                                    | 6.53  | \$ 8.78                         | \$ 149,450                | 39,715                       | \$ 8.70                         | \$ 51,630                 |
| \$1.660 – \$8.860        | 3,174,620                                  | 4.39  | \$ 4.99                         | \$15,919,085              | 2,945,578                    | \$ 4.86                         | \$ 15,134,192             |

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company's closing stock price of \$10.00 on August 25, 2006, which would have been received by holders of stock options had all holders of stock options exercised their stock options that were in-the-money as of that date. The total number of in-the-money stock options exercisable as of August 27, 2006, was approximately 2.9 million shares. The aggregate intrinsic value of stock options exercised during the three month period ended August 27, 2006, was \$264,000.

### Shares Subject to Vesting

The following table summarizes the activity relating to unvested stock option grants and RSUs during the three month period ended August 27, 2006:

|                             | Stock Options |                             | Restricted Stock |                             |
|-----------------------------|---------------|-----------------------------|------------------|-----------------------------|
|                             | Shares        | Weighted Average Fair Value | Shares           | Weighted Average Fair Value |
| Unvested at May 28, 2006    | 182,586       | \$2.43                      | 833              | \$7.53                      |
| Granted                     | 115,000       | \$4.05                      | 38,335           | \$8.32                      |
| Vested/Awarded              | (64,794)      | \$2.29                      | —                | —                           |
| Forfeited                   | (3,750)       | \$6.09                      | —                | —                           |
| Unvested at August 27, 2006 | 229,042       | \$3.23                      | 39,168           | \$8.30                      |

As of August 27, 2006, there was \$1.1 million of total unrecognized compensation expense related to unvested equity compensation awards granted under the Company's incentive stock plan. Total expense is expected to be recognized over the weighted-average period of 1.62 years.

As of August 27, 2006 the Company has reserved 3.9 million shares of common stock for future issuance under its current and former stock plans.

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### 3. 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):

|  | <b>Three Months<br/>Ended<br/>August 27, 2006</b> |
|--|---|
| Numerator:   |   |
| Net income   | \$ 14   |
| Less: Minority interest income of subsidiary           | (114)   |
| Net loss for diluted net loss per share                | \$ (100)  |
| Denominator:   |   |
| Weighted average shares for diluted net loss per share | 24,936  |
| Diluted net loss per share                             | \$ (0.00)   |

For the three months ended August 27, 2006 and August 28, 2005, the computation of the diluted net loss per share excludes the impact of options to purchase 1,367,667 shares and 962,516 shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

### 4. Goodwill and Other Intangibles

The Company is required under SFAS 142 to review goodwill and indefinite lived intangible assets at least annually. During the three months ended August 27, 2006, the Company completed its annual impairment review. The review is performed by grouping the net book value of all long-lived assets for reporting entities, including goodwill and other intangible assets, and comparing this value to the related estimated fair value. The determination of fair value is based on estimated future discounted cash flows related to these long-lived assets. The discount rate used was based on the risks associated with the reporting entities. The determination of fair value was performed by management using the services of an independent appraiser. The review concluded that the fair value of the reporting entities exceeded the carrying value of their net assets and thus no impairment charge was warranted as of August 27, 2006.

### 5. Inventories

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

|                 | August 27,<br>2006 | May 28,<br>2006  |
|-----------------|--------------------|------------------|
| Finished goods  | \$ 11,760          | \$ 10,017        |
| Raw material    | 4,237              | 3,764            |
| Work in process | —                  | 177              |
| Total           | <u>\$ 15,997</u>   | <u>\$ 13,958</u> |

**6. Related Party**

Apio provides cooling and distributing services for farms in which the Chief Executive Officer of Apio (the “Apio CEO”) has a financial interest and purchases produce from those farms. Apio also purchases produce from Beachside Produce LLC (formerly known as Apio Fresh) for sale to third parties. Beachside Produce is owned by a group of entities and persons that supply produce to Apio. One of the owners of Beachside Produce is the Apio CEO. Revenues, cost of product sales and the resulting payable and the note receivable from advances for ground lease payments, crop and harvesting costs, are classified as related party in the accompanying financial statements as of August 27, 2006 and May 28, 2006 and for the three months ended August 27, 2006 and August 28, 2005.

Apio leases, for approximately \$429,000 on an annual basis, agricultural land that is either owned, controlled or leased by the Apio CEO. Apio, in turn, subleases that land at cost to growers who are obligated to deliver product from that land to Apio for value added products. There is generally no net statement of operations impact to Apio as a result of these leasing activities but Apio creates a guaranteed source of supply for the value added business. Apio has loss exposure on the leasing activity to the extent that it is unable to sublease the land. For the three months ended August 27, 2006 the Company subleased all of the land leased from the Apio CEO and received sublease income of \$111,000 which is equal to the amount the Company paid to lease that land for the period.

Apio’s domestic commodity vegetable business was sold to Beachside Produce, effective June 30, 2003. The Apio CEO is a 12.5% owner in Beachside Produce. During the three months ended August 27, 2006, the Company recognized revenues of \$5,000 from the sale of products to Beachside Produce and royalty revenue of \$50,000 from the use by Beachside Produce of Apio’s trademarks. The related accounts receivable from Beachside Produce are classified as related party in the accompanying financial statements as of August 27, 2006 and May 28, 2006.

In addition, the Apio CEO has a 6% ownership interest in Apio Cooling LP, a limited partnership in which Apio is the general partner with a 60% ownership interest. Included in the minority interest liability as of August 27, 2006 and May 28, 2006 is \$196,000 and \$237,000, respectively, owed to the Apio CEO.

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

**7. Insurance Settlement**

On August 25, 2006 the Company received a cash payment of \$1.6 million from the settlement of insurance claims associated with a fire that occurred at its Dock Resins facility in February 2000. The settlement resulted in the Company recording a reduction to selling, general and administrative expenses of \$1.3 million, net of expenses, during the Company’s first quarter of fiscal year 2007. In addition, \$381,000 has been placed in escrow pending the outcome of certain disputed professional fees. In September 2006, the Company resolved the fee dispute and paid professional fees of \$227,000 from the escrow and received the balance of \$154,000.

**8. Comprehensive Loss**

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

**9. Shareholders’ Equity**

During the three months ended August 27, 2006, 71,894 shares of Common Stock were issued upon the exercise of options under the Company’s stock option plan and the Company’s Employee Stock Purchase Plan.

**10. Business Segment Reporting**

Landec operates in two business segments: the Food Products Technology segment and the Agricultural Seed Technology segment. The Food Products Technology segment markets and packs specialty packaged whole and fresh-cut vegetables that incorporate the BreatheWay<sup>®</sup> specialty packaging for the retail grocery, club store and food services industry. The Agricultural Seed Technology segment markets and distributes hybrid seed corn and seed coatings using Landec’s patented Intellicoat<sup>®</sup> seed coatings to the farming industry. The Food Products Technology and Agricultural Seed Technology segments include charges for corporate services allocated from the Corporate and Other segment. Corporate and other amounts include non-core operating activities and corporate operating costs. All of the assets of the Company are located within the United States of America.

Operations by Business Segment (in thousands):

|   | Food Products<br>Technology | Agricultural<br>Seed<br>Technology | Corporate<br>and Other | TOTAL    |
|---|-----------------------------|------------------------------------|------------------------|----------|
| <b>Three months ended August 27, 2006</b> |                             |                                    |                        |          |
| Net revenues                              | \$50,825                    | \$ 114                             | \$ 208                 | \$51,147 |
| International sales                       | \$13,810                    | \$ —                               | \$ —                   | \$13,810 |
| Gross profit                              | \$ 5,354                    | \$ (5)                             | \$ 207                 | \$ 5,556 |
| Net income (loss)                         | \$ 1,722                    | \$(2,889)                          | \$1,181                | \$ 14    |
| Interest expense                          | \$ 70                       | \$ —                               | \$ —                   | \$ 70    |
| Interest income                           | \$ 192                      | \$ 41                              | \$ 3                   | \$ 236   |
| Depreciation and amortization             | \$ 672                      | \$ 189                             | \$ 25                  | \$ 886   |
| <b>Three months ended August 28, 2005</b> |                             |                                    |                        |          |
| Net revenues                              | \$49,498                    | \$ —                               | \$ 207                 | \$49,705 |
| International sales                       | \$16,721                    | \$ —                               | \$ —                   | \$16,721 |
| Gross profit                              | \$ 6,460                    | \$ —                               | \$ 130                 | \$ 6,590 |
| Net income (loss)                         | \$ 1,884                    | \$(2,126)                          | \$ (279)               | \$ (521) |
| Interest expense                          | \$ 73                       | \$ —                               | \$ —                   | \$ 73    |
| Interest income                           | \$ 90                       | \$ 12                              | \$ 18                  | \$ 120   |
| Depreciation and amortization             | \$ 633                      | \$ 106                             | \$ 27                  | \$ 766   |

During the three months ended August 27, 2006 and August 28, 2005, sales to the Company’s top five customers accounted for approximately 51% and 48%, respectively, of revenues with the Company’s top customers from the Food Products Technology segment, Costco Wholesale Corp. accounting for approximately 21% for the three months ended August 27, 2006 and approximately 16% for the three months ended August 28, 2005. 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. Virtually all of the Company’s international sales are to Asia.

**11. Subsequent Events**

On August 28, 2006 the Company amended the Heartland Hybrids, Inc. (“Heartland”) Asset Purchase Agreement. In accordance with the amendment the Company paid the former owners of Heartland a cash earn out payment of \$1.0 million. In exchange for the Company accelerating the earn out payment, the former owners of Heartland agreed to reduce the total potential earn out by \$200,000 (the original earn out potential was \$1.2 million). The Company recorded \$383,000 of the earn out to goodwill during the first quarter of fiscal year 2007 as that was the amount earned in fiscal year 2006. The remaining \$617,000 will be recorded to goodwill during the Company’s second quarter of fiscal year 2007.

On August 29, 2006, Landec Ag amended its revolving line of credit with Old National Bank which increased the line from \$7.5 million to \$10 million. The interest rate on the revolving line of credit was reduced from prime plus 0.375% to prime minus 0.50% (7.75% at August 27, 2006). The line of credit contains certain restrictive covenants, which, among other things, restrict the ability of Landec Ag to make payments on debt owed by Landec Ag to Landec. Landec Ag was in compliance with all of the loan covenants during the first quarter of

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fiscal year 2007. Landec has pledged substantially all of the assets of Landec Ag to secure the line of credit. At August 27, 2006, no amounts were outstanding under Landec Ag's revolving line of credit.

### 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 28, 2006.

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Potential risks and uncertainties include, without limitation, those mentioned in this report and, in particular the factors described below under "Additional Factors That May Affect Future Results," and those mentioned in Landec's Annual Report on Form 10-K for the fiscal year ended May 28, 2006. 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 28, 2006 filed with the Securities and Exchange Commission on July 27, 2006 with the exception of the adoption of SFAS No. 123(R).

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

Effective January 1, 2006, we measure compensation expense for our stock-based compensation plans using the fair value method as defined in SFAS No. 123(R). Under SFAS 123R, stock-based compensation expense is calculated based on the value of the award on the date of grant and is recognized as expense on a straight line basis over the vesting period. Determining the fair value of stock-based awards on the grant date requires judgment, including estimating the amount of stock-based awards that are expected to be forfeited. To the extent actual results or updated estimates differ from our prior estimates, such amounts will be recorded as a cumulative adjustment in the period that any such estimates are revised. If actual results differ significantly from what we previously estimated, our stock-based compensation expense and our results of operations could be materially impacted.

#### 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<sup>®</sup> 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.

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Landec has two core businesses – Food Products Technology and Agricultural Seed Technology, in addition to our Technology Licensing/Research and Development business which is included in Corporate and Other for segment disclosure purposes (see note 10).

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”).

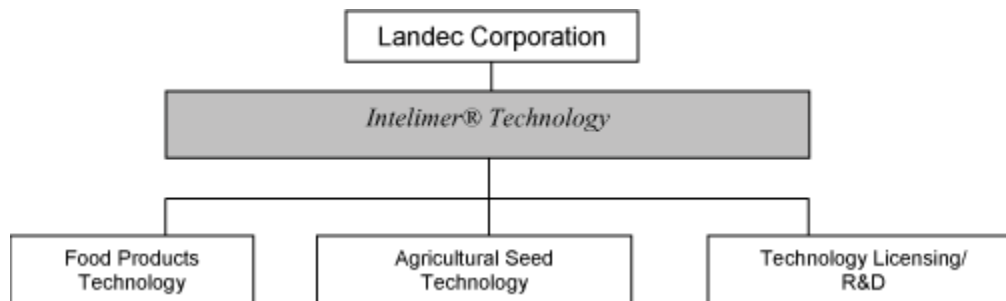
Our Agricultural Seed Technology business is operated through a subsidiary, Landec Ag, Inc., (“Landec Ag”) and combines our proprietary Intellicoat® seed coating technology with our unique e-commerce, direct marketing and consultative selling capabilities which we obtained when we acquired Fielder’s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

In addition to our two core businesses, the Company also operates a Technology Licensing/Research and Development business that licenses and/or supplies products outside of our core businesses to industry leaders such as Air Products and Chemicals, Inc.

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

### Description of Core Business

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



### *Food Products Technology Business*

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



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business has been combined with Apio into a wholly owned subsidiary that retains the Apio, Inc. name. This vertical integration within the Food Products Technology business gives Landec direct access to the large and growing fresh-cut produce market.

Based in Guadalupe, California, Apio, when acquired in December 1999, consisted of two major businesses – first, the “fee-for-service” selling and marketing of whole produce and second, the specialty packaged fresh-cut and whole value-added processed products that are washed and packaged in our proprietary BreatheWay® packaging. The “fee-for-service” business historically included field harvesting and packing, cooling and marketing of vegetables and fruit on a contract basis for growers in California’s Santa Maria, San Joaquin and Imperial Valleys as well as in Arizona and Mexico. The Company exited this business and certain assets associated with the business were sold in June 2003 to Beachside Produce LLC (formerly known as Apio Fresh) (“Beachside”). Beachside is owned by a group of entities and persons that supply produce to Apio, including Nicholas Tompkins, Apio’s President and Chief Executive Officer. Under the terms of the sale, Beachside purchased certain equipment and carton inventory from Apio in exchange for approximately \$410,000. In connection with the sale, Beachside pays Apio an on-going royalty fee per carton sold for the use of Apio’s brand names and Beachside and its growers entered into a long-term supply agreement with Apio to supply produce to Apio for its fresh-cut value-added products. The fresh-cut value-added processed products business markets a variety of fresh-cut and whole vegetables to the top retail grocery chains and club stores. During the fiscal year ended May 28, 2006, Apio shipped more than seventeen million cartons of produce to leading supermarket retailers, wholesalers, foodservice suppliers and club stores throughout the United States and internationally, primarily in Asia.

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

- **Value-Added Supplier:** Apio has structured its business as a marketer and seller of fresh-cut and whole value-added produce. It is focused on selling products under its Eat Smart® brand and other brands for its fresh-cut and whole value-added products. As retail grocery and club store chains consolidate, Apio is well positioned as a single source of a broad range of products.
- **Reduced Farming Risks:** Apio reduces its farming risk by not taking ownership of farmland, and instead, contracts with growers for produce. The year-round sourcing of produce is a key component to the fresh-cut and whole value-added processing business.
- **Lower Cost Structure:** Apio has strategically invested in the rapidly growing fresh-cut and whole value-added business. Apio’s 60,000 square foot value-added processing plant is automated with state-of-the-art vegetable processing equipment. Virtually all of Apio’s value-added products utilize Apio’s proprietary BreatheWay packaging technology. Apio’s strategy is to operate one large central processing facility in one of California’s largest, lowest cost growing regions (Santa Maria Valley) and use packaging technology to allow for the nationwide delivery of fresh produce products.
- **Export Capability:** Apio is uniquely positioned to benefit from the growth in export sales to Asia and Europe over the next decade with its export business, CalEx. Through CalEx, Apio is currently one of the largest U.S. exporters of broccoli to Asia and is selling its iceless products to Asia using proprietary BreatheWay packaging technology .
- **Expanded Product Line Using Technology:** Apio, through the use of its BreatheWay packaging technology, is introducing on average fifteen new value-added products each year. These new product offerings range from various sizes of fresh-cut bagged products, to vegetable trays, to whole produce, to a meal line of products. During the last twelve months, Apio has introduced 21 new products.

### *Agricultural Seed Technology Business*

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

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

Landec Ag's Intellicoat seed coating applications are designed to control seed germination timing, increase crop yields, reduce risks and extend crop-planting windows. These coatings are currently available on hybrid corn, soybeans and male inbred corn used for seed production. In fiscal year 2000, Landec Ag launched its first commercial product, Pollinator Plus ® coatings, which is a coating application used by seed companies as a method for spreading pollination to increase yields and reduce risk in the production of hybrid seed corn. There are approximately 650,000 acres of seed production in the United States and in 2006 Pollinator Plus was used by 35 seed companies on approximately 15% of the seed production acres in the U.S.

In 2003, Landec Ag commercialized Early Plant ® corn by selling the product directly to farmers through its Fielder's Choice Direct ® brand. This application allows farmers to plant into cold soils without the risk of chilling injury, and enables farmers to plant as much as four weeks earlier than normal. With this capability, farmers are able to utilize labor and equipment more efficiently, provide flexibility during the critical planting period and avoid yield losses caused by late planting. In 2006, nine seed companies offered Intellicoat on their hybrid seed corn offerings.

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

Based in Monticello, Indiana, Fielder's Choice Direct offers a comprehensive line of corn hybrids and alfalfa to more than 12,000 farmers in over forty states through direct marketing programs. The success of Fielder's Choice comes, in part, from its expertise in selling directly to the farmer, bypassing the traditional and costly farmer-dealer system. We believe that this direct channel of distribution provides up to a 35% cost advantage compared to the farmer-dealer system.

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

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

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

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

We believe our technology has commercial potential in a wide range of industrial, consumer and medical applications beyond those identified in our core businesses. For example, our core patented technology, Intelimer materials, can be used to trigger the release of small molecule drugs, catalysts, pesticides or fragrances just by changing the temperature of the Intelimer materials or to activate adhesives through controlled temperature change. In order to

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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.

### Results of Operations

Revenues (in thousands):

|                            | Three months<br>ended 8/27/06 | Three months<br>ended 8/28/05 | Change |
|----------------------------|-------------------------------|-------------------------------|--------|
| <i>Apio Value Added</i>    | \$ 35,030                     | \$ 29,660                     | 18%    |
| <i>Apio Tech</i>           | 13                            | 4                             | 225%   |
| <i>Technology Subtotal</i> | 35,043                        | 29,664                        | 18%    |
| <i>Apio Trading</i>        | 15,782                        | 19,834                        | (20%)  |
| <i>Total Apio</i>          | 50,825                        | 49,498                        | 3%     |
| <i>Landec Ag</i>           | 114                           | —                             | N/M    |
| <i>Corporate</i>           | 208                           | 207                           | 0%     |
| <i>Total Revenues</i>      | \$ 51,147                     | \$ 49,705                     | 3%     |

#### *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 increase in Apio's value-added revenues for the three months ended August 27, 2006 compared to the same period last year is due to increased product offerings, increased sales to existing customers, the addition of new customers and product mix changes to higher priced products. Specifically, sales of Apio's value-added 12-ounce specialty packaged retail product line grew 23%, during the three months ended August 27, 2006 compared to the same period last year. In addition, sales of Apio's value-added vegetable tray products grew 23% during the three months ended August 27, 2006 compared to the same period last year. Overall value-added sales volume increased 17% during the first quarter of fiscal year 2007 compared to the same period last year.

#### *Apio Tech*

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

The increase in revenues at Apio Tech during the three months ended August 27, 2006 compared to the same period last year was not material to consolidated Landec revenues.

#### *Apio Trading*

Apio trading revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia through Apio's export company, Cal-Ex and from the purchase and sale of whole commodity fruit and vegetable products domestically to Wal-Mart. The export portion of trading revenues for the first quarter of fiscal year 2007 was \$13.8 million or 88% of total trading revenues.

The decrease in revenues in Apio's trading business for the three months ended August 29, 2006 compared to the same period last year was primarily due to a 24% decrease in export sales volumes and a planned 77% decrease in buy/sell commodity volumes sold to Wal-Mart.

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### *Landec Ag*

Landec Ag revenues consist of revenues generated from the sale of hybrid seed corn to farmers under the Fielder's Choice Direct brand and from the sale of hybrid seed corn and soybeans under the Heartland Hybrids® brand and from the sale of Intellicoat coated corn and soybean seeds to farmers and seed companies. Virtually all of Landec Ag's revenues are generated during the Company's third and fourth quarters.

The increase in revenues at Landec Ag during the three months ended August 27, 2006 compared to the same period last year was not material to consolidated Landec revenues.

### *Corporate*

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

The increase in Corporate revenues for the three months ended August 27, 2006 compared to the same period of the prior year was not material to consolidated Landec revenues.

### **Gross Profit** (in thousands):

|                            | <i>Three months<br/>ended 8/27/06</i> | <i>Three months<br/>ended 8/28/05</i> | <i>Change</i> |
|----------------------------|---------------------------------------|---------------------------------------|---------------|
| <i>Apio Value Added</i>    | \$ 4,523                              | \$ 5,513                              | (18%)         |
| <i>Apio Tech</i>           | 4                                     | 2                                     | 100%          |
| <i>Technology Subtotal</i> | 4,527                                 | 5,515                                 | (18%)         |
| <i>Apio Trading</i>        | 827                                   | 945                                   | (12%)         |
| <i>Total Apio</i>          | 5,354                                 | 6,460                                 | (17%)         |
| <i>Landec Ag</i>           | (5)                                   | —                                     | N/M           |
| <i>Corporate</i>           | 207                                   | 130                                   | 59%           |
| <i>Total Gross Profit</i>  | \$ 5,556                              | \$ 6,590                              | (16%)         |

### *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, seeds and packaging), direct labor, overhead (including indirect labor, depreciation, and facility related costs) and shipping and shipping related costs. The following discussion surrounding gross profit includes management's best estimates of the reasons for the changes for the first quarter of fiscal year 2007 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 27, 2006 compared to the same period last year was primarily due to the increased costs for raw materials in the first quarter of fiscal year 2007 compared to the first quarter of last year was attributable to weather related shortages of contracted product which required Apio to procure supplement product on the open market at costs significantly above contracted prices. The increase in raw material costs was partially offset by an increase in revenues of 18% during the first quarter of fiscal year 2007 compared to the first quarter of last year and changes in product mix to higher margin products coupled with improved operational efficiencies.

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### *Apio Tech*

The increase in gross profit for Apio Tech for the three months ended August 27, 2006 compared to the same period last year was not material to consolidated Landec gross profit.

### *Apio Trading*

Apio's trading business is a buy/sell business that realizes a commission-based margin in the 4-6% range. The decrease in gross profit during the three months ended August 27, 2006 compared to the same period last year was primarily due to a 20% decrease in revenues which was partially offset by a shift during the first quarter of fiscal year 2007 to higher margin export products from lower margin domestic commodity products compared to the first quarter last year.

### *Landec Ag and Corporate*

The decrease in gross profit for Landec Ag and Corporate for the three months ended August 27, 2006 compared to the same period last year was not material to consolidated Landec gross profit.

## Operating Expenses (in thousands):

|  | <i>Three months<br/>ended 8/27/06</i> | <i>Three months<br/>ended 8/28/05</i> | <i>Change</i> |
|--|---------------------------------------|---------------------------------------|---------------|
| <b><i>Research and Development:</i></b>            |                                       |                                       |               |
| <i>Apio</i>  | \$ 241                                | \$ 266                                | (9%)          |
| <i>Landec Ag</i>                                   | 136                                   | 153                                   | (11%)         |
| <i>Corporate</i>                                   | 407                                   | 339                                   | 20%           |
| <b><i>Total R&amp;D</i></b>                        | <b>\$ 784</b>                         | <b>\$ 758</b>                         | <b>3%</b>     |
| <b><i>Selling, General and Administrative:</i></b> |                                       |                                       |               |
| <i>Apio</i>  | \$ 2,791                              | \$ 3,421                              | (18%)         |
| <i>Landec Ag</i>                                   | 2,326                                 | 1,629                                 | 43%           |
| <i>Corporate</i>                                   | (215)                                 | 1,133                                 | (119%)        |
| <b><i>Total S,G&amp;A</i></b>                      | <b>\$ 4,902</b>                       | <b>\$ 6,183</b>                       | <b>(21%)</b>  |

### *Research and Development*

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

The increase in research and development expenses for the three months ended August 27, 2006 compared to the same period last year was not material.

### *Selling, General and Administrative*

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

The decrease in selling, general and administrative expenses for the three months ended August 27, 2006 compared to the same period last year was primarily due to new packaging design and marketing related costs that

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were incurred at Apio during the first quarter of fiscal year 2006 and the recording of the net proceeds of \$1.3 million from the insurance settlement (see Note 7) to Corporate selling, general and administrative expenses during the first quarter of fiscal year 2007. These decreases were partially offset by the increase at Landec Ag resulting from incurring \$574,000 of selling, general and administrative costs that were incurred at Heartland Hybrids during the first quarter this year compared to zero during the first quarter last year because Heartland Hybrids was not acquired until the beginning of Landec's second fiscal quarter.

**Other** (in thousands):

|                              | <i>Three months<br/>ended 8/27/06</i> | <i>Three months<br/>ended 8/28/05</i> | <i>Change</i> |
|------------------------------|---------------------------------------|---------------------------------------|---------------|
| <i>Interest Income</i>       | \$ 236                                | \$ 120                                | 97%           |
| <i>Interest Expense</i>      | (70)                                  | (73)                                  | (4%)          |
| <i>Minority Interest Exp</i> | (18)                                  | (215)                                 | (92%)         |
| <i>Other Expense</i>         | (4)                                   | (2)                                   | 100%          |
| <i>Total Other</i>           | \$ 144                                | \$ (170)                              | 185%          |

### *Interest Income*

The increase in interest income for the three months ended August 27, 2006 compared to the same period last year was primarily due to the increase in cash available for investing and higher interest rates on the cash invested.

### *Interest Expense*

The decrease in interest expense during the three months ended August 27, 2006 compared to the same period last year was due to the Company's reduction of debt.

### *Minority Interest Expense*

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

The decrease in the minority interest for the three months ended August 27, 2006 compared to the first quarter of last year was due to non-recurring gains on Apio Cooling's books during the first quarter of fiscal year 2006.

### *Other*

Other consists of non-operating income and expenses.

## **Liquidity and Capital Resources**

As of August 27, 2006, the Company had cash and cash equivalents of \$14.4 million, a net decrease of \$6.1 million from \$20.5 million at May 28, 2006.

### *Cash Flow from Operating Activities*

Landec used \$1.9 million of cash flow in operating activities during the three months ended August 27, 2006 compared to using \$2.2 million in operating activities for the three months ended August 28, 2005. The primary uses of cash in operating activities were from an increase in inventory at Apio of \$1.6 million primarily due to an increase in export inventory in transit which will be recorded to revenue during the second quarter of fiscal year 2007 and from the payment of bonuses earned in fiscal year 2006. These uses of operating cash flow were

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partially offset by a \$2.4 million reduction of accounts receivable at Apio that was a result of high revenues in the last month of fiscal year 2006 that were collected during the first quarter of fiscal year 2007.

### *Cash Flow from Investing Activities*

Net cash used in investing activities for the three months ended August 27, 2006 was \$2.3 million compared to \$1.6 million for the same period last year. The primary uses of cash for investing activities during the first quarter of fiscal year 2007 were for the purchase of \$2.3 million of property and equipment primarily for the further expansion and automation of Apio's value-added facility.

### *Cash Flow from Financing Activities*

Net cash used in financing activities for the three months ended August 27, 2006 was \$1.9 million compared to \$574,000 for the same period last year. The cash used in financing activities during the first quarter of fiscal year 2007 was primarily used to pay off all of Apio's long-term bank debt totaling \$2.0 million.

### *Capital Expenditures*

During the three months ended August 27, 2006, Landec began an 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 \$2.3 million of capital expenditures.

### *Debt*

On November 1, 2005, Apio amended its revolving line of credit with Wells Fargo Bank N.A. that was scheduled to expire on August 31, 2006. The line was reduced from \$10.0 million to \$7.0 million and outstanding amounts under the line of credit now bear interest at either the prime rate less 0.25% or the LIBOR adjustable rate plus 1.75% (7.08% at August 27, 2006). The revolving line of credit with Wells Fargo (collectively, the "Loan Agreement") contains certain restrictive covenants, which require Apio to meet certain financial tests, including minimum levels of net income, maximum leverage ratio, minimum net worth and maximum capital expenditures. Landec has pledged substantially all of the assets of Apio to secure the lines with Wells Fargo. At August 27, 2006, no amounts were outstanding under the revolving line of credit. Apio has been in compliance with all loan covenants in the Loan Agreement since the inception of this loan.

On August 29, 2006, Landec Ag amended its revolving line of credit with Old National Bank which increased the line from \$7.5 million to \$10 million. The interest rate on the revolving line of credit was reduced from prime plus 0.375% to prime minus 0.50% (7.75% at August 27, 2006). The line of credit contains certain restrictive covenants, which, among other things, restrict the ability of Landec Ag to make payments on debt owed by Landec Ag to Landec. Landec Ag was in compliance with all of the loan covenants during the first quarter of fiscal year 2007. Landec has pledged substantially all of the assets of Landec Ag to secure the line of credit. At August 27, 2006, no amounts were outstanding under Landec Ag's revolving line of credit.

At August 27, 2006, Landec's total debt, including current maturities and capital lease obligations, was \$45,000 and the total debt to equity ratio was 0% as compared to 2% at May 28, 2006. This debt was comprised of capital lease obligations. The amount of debt outstanding on the Company's revolving lines of credit fluctuates over time. Borrowings on Landec's lines of credit are expected to vary with seasonal requirements of the Company's businesses.



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### Contractual Obligation

The Company's material contractual obligations for the next five years and thereafter as of August 27, 2006, are as follows (in thousands):

| Obligation           | Due in Fiscal Year Ended May |                      |               |               |               |               |               |
|----------------------|------------------------------|----------------------|---------------|---------------|---------------|---------------|---------------|
|                      | Total                        | Remainder<br>of 2007 | 2008          | 2009          | 2010          | 2011          | Thereafter    |
| Lines of Credit      | \$ —                         | \$ —                 | \$ —          | \$ —          | \$ —          | \$ —          | \$ —          |
| Long-term Debt       | —                            | —                    | —             | —             | —             | —             | —             |
| Capital Leases       | 45                           | 45                   | —             | —             | —             | —             | —             |
| Operating Leases     | 2,060                        | 753                  | 737           | 444           | 123           | 3             | —             |
| Licensing Obligation | 550                          | 50                   | 100           | 100           | 100           | 100           | 100           |
| Purchase Commitments | 563                          | 563                  | —             | —             | —             | —             | —             |
| Total                | <u>\$ 3,218</u>              | <u>\$ 1,411</u>      | <u>\$ 837</u> | <u>\$ 544</u> | <u>\$ 223</u> | <u>\$ 103</u> | <u>\$ 100</u> |

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

Landec's future capital requirements will depend on numerous factors, including the progress of its research and development programs; the development of commercial scale manufacturing capabilities; the development of marketing, sales and distribution capabilities; the ability of Landec to establish and maintain new collaborative and licensing arrangements; any decision to pursue additional acquisition opportunities; weather conditions that can affect the supply and price of produce, the timing and amount, if any, of payments received under licensing and research and development agreements; the costs involved in preparing, filing, prosecuting, defending and enforcing intellectual property rights; the ability to comply with regulatory requirements; the emergence of competitive technology and market forces; the effectiveness of product commercialization activities and arrangements; and other factors. If Landec's currently available funds, together with the internally generated cash flow from operations are not sufficient to satisfy its capital needs, Landec would be required to seek additional funding through other arrangements with collaborative partners, additional bank borrowings or 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, marketable securities and existing borrowing capacities will be sufficient to finance its operational and capital requirements through at least the next twelve months.

### Additional Factors That May Affect Future Results

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

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

In the past, our results of operations have fluctuated significantly from quarter to quarter and are expected to continue to fluctuate in the future. Historically, our direct marketer of hybrid corn seed, Landec Ag, has been the primary source of these fluctuations, as its revenues and profits are concentrated over a few months during the spring planting season (generally during our third and fourth fiscal quarters). In addition, Apio can be heavily affected by seasonal and weather factors which have impacted quarterly results, such as the high cost of sourcing product in



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March/April 2005 and June/July 2006 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.

### ***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

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and medical companies is expected to be intense. In addition, the nature of our collaborative arrangements may result in our corporate partners and licensees becoming our competitors. Many of these competitors have substantially greater financial and technical resources and production and marketing capabilities than we do, and may have substantially greater experience in conducting clinical and field trials, obtaining regulatory approvals and manufacturing and marketing commercial products.

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

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

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

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

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

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

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

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

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

### ***We Depend on Strategic Partners and Licenses for Future Development***

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

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

Our products and operations are subject to governmental regulation in the United States and foreign countries. The manufacture of our products is subject to periodic inspection by regulatory authorities. We may not be able to obtain necessary regulatory approvals on a timely basis or at all. Delays in receipt of or failure to receive approvals or loss of previously received approvals would have a material adverse effect on our business, financial condition and

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results of operations. Although we have no reason to believe that we will not be able to comply with all applicable regulations regarding the manufacture and sale of our products and polymer materials, regulations are always subject to change and depend heavily on administrative interpretations and the country in which the products are sold. Future changes in regulations or interpretations relating to matters such as safe working conditions, laboratory and manufacturing practices, environmental controls, and disposal of hazardous or potentially hazardous substances may adversely affect our business.

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

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

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

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

For the three months ended August 27, 2006, approximately 27% 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 first three months of fiscal year 2007, sales to our top five customers accounted for approximately 51% of our revenues, with our largest customers, Costco Wholesale Corp. accounting for approximately 21% of our revenues. We expect that, for the foreseeable future, a limited number of customers may continue to account for a substantial portion of our net revenues. We may experience changes in the composition of our customer base as we have experienced in the past. We do not have long-term purchase agreements with any of our customers. The reduction, delay or cancellation of orders from one or more major customers for any reason or the loss of one or more of our major customers could materially and adversely affect our business, operating results and financial condition. In

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addition, since some of the products processed by Apio at its Guadalupe, California facility are sole sourced to its customers, our operating results could be adversely affected if one or more of our major customers were to develop other sources of supply. Our current customers may not continue to place orders, orders by existing customers may be canceled or may not continue at the levels of previous periods or we may not be able to obtain orders from new customers.

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

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

### ***Our Stock Price May Fluctuate in Accordance with Market Conditions***

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

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

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

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

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

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

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

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

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

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

Our executive officers and directors and their affiliates own or control approximately 23% of our common stock (including options exercisable within 60 days). Accordingly, these officers, directors and shareholders may have the ability to exert significant influence over the election of our Board of Directors, the approval of amendments to our articles and bylaws and the approval of mergers or other business combination transactions requiring shareholder approval. This concentration of ownership may have the effect of delaying or preventing a merger or other business combination transaction, even if the transaction or amendments would be beneficial to our other shareholders. In addition, our controlling shareholders may approve amendments to our articles or bylaws to implement anti-takeover or management friendly provisions that may not be beneficial to our other shareholders.

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

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

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

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

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

Our Board of Directors has the authority, without further approval of our shareholders, to fix the rights and preferences, and to issue shares, of preferred stock. In November 1999, we issued and sold shares of Series A Convertible Preferred Stock and in October 2001 we issued and sold shares of Series B Convertible Preferred Stock.

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The Series A Convertible Preferred Stock was converted into 1,666,670 shares of Common Stock on November 19, 2002 and the Series B Convertible Preferred Stock was converted into 1,744,102 shares of Common Stock on May 7, 2004.

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

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

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

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

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



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

The following table presents information about the Company's debt obligations and derivative financial instruments that are sensitive to changes in interest rates. The table presents principal amounts and related weighted average interest rates by year of expected maturity for the Company's debt obligations. The carrying value of the Company's debt obligations approximates the fair value of the debt obligations as of August 27, 2006.

|  | Remainder<br>of 2007 | 2008 | 2009 | 2010 | 2011 | There-after | Total |
|--|----------------------|------|------|------|------|-------------|-------|
| <b>Liabilities (in 000's)</b>                |                      |      |      |      |      |             |       |
| Lines of Credit                              | \$ —                 | \$—  | \$—  | \$—  | \$—  | \$—         | \$ —  |
| Avg. Int. Rate                               |                      |      |      |      |      |             |       |
| Long term debt, including<br>current portion |                      |      |      |      |      |             |       |
| Fixed Rate                                   | \$ 45                | \$—  | \$—  | \$—  | \$—  | \$—         | \$ 45 |
| Avg. Int. Rate                               | 5.90%                |      |      |      |      |             | 5.90% |

### 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 to provide reasonable assurance that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

#### Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting during the quarter ended August 27, 2006 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 would result in the payment of any amounts that would be material to the business or financial condition of the Company.

**Item 1A. Risk Factors**

Not applicable.

**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:   |
|----------------|--|
| 10.69+         | Business Loan Agreement by and among Landec Ag, Inc., as Borrower, and Old National Bank, dated as of August 29, 2006. |
| 31.1+          | CEO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2+          | CFO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1+          | CEO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2+          | CFO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.   |

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+ Filed herewith.

**SIGNATURES**

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

LANDEC CORPORATION

By: /s/ Gregory S. Skinner

Gregory S. Skinner

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

Date: September 29, 2006

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### Exhibit Index

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| 10.69+         | Business Loan Agreement by and among Landec Ag, Inc., as Borrower, and Old National Bank, dated as of August 29, 2006. |
| 31.1+          | CEO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2+          | CFO Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1+          | CEO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2+          | CFO Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.   |

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+ Filed herewith.



**BUSINESS LOAN AGREEMENT**

|                 |            |            |             |           |         |         |          |
|-----------------|------------|------------|-------------|-----------|---------|---------|----------|
| Principal       | Loan Date  | Maturity   | Loan No.    | Call/Coll | Account | Officer | Initials |
| \$10,000,000.00 | 08-29-2006 | 08-31-2007 | 20105324894 | 160/61    |         | U53     |          |

References in the shaded area are for Lender’s use only and do not limit the applicability of this document to any particular loan or item.

Any item above containing “\*\*\*” has been omitted due to text length limitations.

|          |  |        |  |
|----------|--|--------|--|
| Borrower | Landec Ag. Inc.<br>306 N. Main Street<br>Monticello, IN 47960-2133 | Lender | OLD NATIONAL BANK<br>181 INDIANAPOLIS COMMERCIAL LPO<br>101 WEST OHIO ST. SUITE 2200<br>INDIANAPOLIS, IN 46204<br>(317) 693-2562 |
|----------|--|--------|--|

**THIS BUSINESS LOAN AGREEMENT** dated August 29, 2006, is made and executed between Landec Ag, Inc. (“Borrower”) and OLD NATIONAL BANK (“Lender”) on the following terms and conditions. Borrower has received prior commercial loans from Lender or has applied to Lender for a commercial loan or loans or other financial accommodations, including those which may be described on any exhibit or schedule attached to this Agreement (“Loan”). Borrower understands and agrees that: (A) in granting, renewing, or extending any Loan, Lender is relying upon Borrower’s representations, warranties, and agreements as set forth in this Agreement; (B) the granting, renewing, or extending of any Loan by Lender at all times shall be subject to Lender’s sole judgment and discretion; and (C) all such Loans shall be and remain subject to the terms and conditions of this Agreement.

**TERM.** This Agreement shall be effective as of August 29, 2006, and shall continue in full force and effect until such time as all of Borrower’s Loans in favor of Lender have been paid in full, including principal, interest, costs, expenses, attorneys’ fees, and other fees and charges, or until such time as the parties may agree in writing to terminate this Agreement.

**CONDITIONS PRECEDENT TO EACH ADVANCE.** Lender’s obligation to make the initial Advance and each subsequent Advance under this Agreement shall be subject to the fulfillment to Lender’s satisfaction of all of the conditions set forth in this Agreement and in the Related Documents.

**Loan Documents.** Borrower shall provide to Lender the following documents for the Loan: (1) the Note; (2) Security Agreements granting to Lender security interests in the Collateral; (3) financing statements and all other documents perfecting Lender’s Security Interests; (4) evidence of insurance as required below; (5) guaranties; (6) subordinations; (7) together with all such Related Documents as Lender may require for the Loan; all in form and substance satisfactory to Lender and Lender’s counsel.

**Borrower’s Authorization.** Borrower shall have provided in form and substance satisfactory to Lender properly certified resolutions, duly authorizing the execution and delivery of this Agreement, the Note and the Related Documents. In addition, Borrower shall have provided such other resolutions, authorizations, documents and instruments as Lender or its counsel, may require.

**Payment of Fees and Expenses.** Borrower shall have paid to Lender all fees, charges, and other expenses which are then due and payable as specified in this Agreement or any Related Document.

**Representations and Warranties.** The representations and warranties set forth in this Agreement, in the Related Documents, and in any document or certificate delivered to Lender under this Agreement are true and correct.

**No Event of Default.** There shall not exist at the time of any Advance a condition which would constitute an Event of Default under this Agreement or under any Related Document.

**REPRESENTATIONS AND WARRANTIES.** Borrower represents and warrants to Lender, as of the date of this Agreement, as of the date of each disbursement of loan proceeds, as of the date of any renewal, extension or modification of any Loan, and at all times any Indebtedness exists:

**Organization.** Borrower is a corporation for profit which is, and at all times shall be, duly organized, validly existing, and in good standing under and by virtue of the laws of the State of Delaware. Borrower is duly authorized to transact business in the State of Indiana and all other states in which Borrower is doing business, having obtained all necessary filings, governmental licenses and approvals for each state in which Borrower is doing business. Specifically, Borrower is, and at all times shall be, duly qualified as a foreign corporation in all states in which the failure to so qualify would have a material adverse effect on its business or financial condition. Borrower has the full power and authority to own its properties and to transact the business in which it is presently engaged or presently proposes to engage. Borrower maintains its principal office at 306 N. Main Street, Monticello, IN 47960-2133. Unless Borrower has designated otherwise in writing, this is the principal office at which Borrower keeps its books and records including its records concerning the Collateral. Borrower will notify

Lender prior to any change in the location of Borrower’s state of organization or any change in Borrower’s name. Borrower shall do all things necessary to preserve and to keep in full force and effect its existence, rights and privileges, and shall comply with all regulations, rules, ordinances, statutes, orders and decrees of any governmental or quasi-governmental authority or court applicable to Borrower and Borrower’s business activities.

**Assumed Business Names.** Borrower has filed or recorded all documents or filings required by law relating to all assumed business names used by Borrower. Excluding the name of Borrower, the following is a complete list of all assumed business names under which Borrower does business:

| <u>Borrower</u> | <u>Assumed Business Name</u> | <u>Filing Location</u> | <u>Date</u> |
|-----------------|------------------------------|------------------------|-------------|
| Landec Ag, Inc. | Fielder’s Choice Direct      | County                 | 10-06-1997  |
| Landec Ag, Inc. | Heartland Hybrids            | County                 |             |

**Authorization.** Borrower’s execution, delivery, and performance of this Agreement and all the Related Documents have been duly authorized by all necessary action by Borrower and do not conflict with, result in a violation of, or constitute a default under (1) any provision of (a) Borrower’s articles of incorporation or organization, or bylaws, or (b) any agreement or other instrument binding upon Borrower or (2) any law, governmental regulation, court decree, or order applicable to Borrower or to Borrower’s properties.

**Financial Information.** Each of Borrower’s financial statements supplied to Lender truly and completely disclosed Borrower’s financial condition as of the date of the statement, and there has been no material adverse change in Borrower’s financial condition subsequent to the date of the most recent financial statement supplied to Lender. Borrower has no material contingent obligations except as disclosed in such financial statements.

**Legal Effect.** This Agreement constitutes, and any instrument or agreement Borrower is required to give under this Agreement when delivered will constitute legal, valid, and binding obligations of Borrower enforceable against Borrower in accordance with their respective terms.

**Properties .** Except as contemplated by this Agreement or as previously disclosed in Borrower’s financial statements or in writing to Lender and as accepted by Lender, and except for property tax liens for taxes not presently due and payable, Borrower owns and has good title to all of Borrower’s properties free and clear of all Security Interests, and has not executed any security documents or financing statements relating to such properties. All of Borrower’s properties are titled in Borrower’s legal name, and Borrower has not used or filed a financing statement under any other name for at least the last five (5) years.

**Hazardous Substances.** Except as disclosed to and acknowledged by Lender in writing, Borrower represents and warrants that: (1) During the period of Borrower’s ownership of the Collateral, there has been no use, generation, manufacture, storage, treatment, disposal, release or threatened release of any Hazardous Substance by any person on, under, about or from any of the Collateral. (2) Borrower has no knowledge of, or reason to believe that there has been (a) any breach or violation of any Environmental Laws; (b) any use, generation, manufacture, storage, treatment, disposal, release or threatened release of any Hazardous Substance on, under, about or from the Collateral by any prior owners or occupants of any of the Collateral; or (c) any actual or threatened litigation or claims of any kind by any person relating to such matters. (3) Neither Borrower nor any tenant, contractor, agent or other authorized user of any of the Collateral shall use, generate, manufacture, store, treat, dispose of or release any Hazardous Substance on, under, about or from any of the Collateral; and any such activity shall be conducted in compliance with all applicable federal, state, and local laws, regulations, and ordinances., including without limitation all Environmental Laws. Borrower authorizes Lender and its agents to enter upon the Collateral to make such inspections and tests as Lender may deem appropriate to determine compliance of the Collateral with this section of the Agreement. Any inspections or tests made by Lender shall be at Borrower’s expense and for Lender’s purposes only and shall not be construed to create any responsibility or liability on the part of Lender to Borrower or to any other person. The representations and warranties contained herein are based on Borrower’s due diligence in investigating the Collateral for hazardous waste and Hazardous Substances. Borrower hereby (1) releases and waives any future claims against Lender for indemnity or contribution in the event Borrower becomes liable for cleanup or other costs under any such laws, and (2) agrees to indemnify, defend, and hold harmless Lender against any and all claims, classes, liabilities, damages, penalties, and expenses which Lender may directly or indirectly sustain or suffer resulting from a breach of this section of the Agreement or as a consequence of any use, generation, manufacture, storage, disposal, release or threatened release of a hazardous waste or substance on the Collateral. The provisions of this section of the Agreement, including the obligation to indemnify and defend, shall survive the payment of the Indebtedness and the termination, expiration or satisfaction of this

Agreement and shall not be affected by Lender's acquisition of any interest in any of the Collateral, whether by foreclosure or otherwise.

**Litigation and Claims.** No litigation, claim, investigation, administrative proceeding or similar action (including those for unpaid taxes) against Borrower is pending or threatened, and no other event has occurred which may materially adversely affect Borrower's financial condition or properties, other than litigation, claims, or other events, if any, that have been disclosed to and acknowledged by Lender in writing.

**Taxes.** To the best of Borrower's knowledge, all of Borrower's tax returns and reports that are or were required to be filed, have been filed, and all taxes, assessments and other governmental charges have been paid in full, except those presently being or to be contested by Borrower in good faith in the ordinary course of business and for which adequate reserves have been provided.

**Lien Priority.** Unless otherwise previously disclosed to Lender in writing, Borrower has not entered into or granted any Security Agreements, or permitted the filing or attachment of any Security interests on or affecting any of the Collateral directly or indirectly securing repayment of Borrower's Loan and Note, that would be prior or that may in any way be superior to Lender's Security interests and rights in and to such Collateral.

**Binding Effect.** This Agreement, the Note, all Security Agreements (if any), and all Related Documents are binding upon the signers thereof, as well as upon their successors, representatives and assigns, and are legally enforceable in accordance with their respective terms.

**AFFIRMATIVE COVENANTS.** Borrower covenants and agrees with Lender that, so long as this Agreement remains in effect, Borrower will:

**Notices of Claims and Litigation.** Promptly inform Lender in writing of (1) all material adverse changes in Borrower's financial condition, and (2) all existing and all threatened litigation, claims, investigations, administrative proceedings or similar actions affecting Borrower or any Guarantor which could materially affect the financial condition of Borrower or the financial condition of any Guarantor.

**Financial Records.** Maintain its books and records in accordance with GAAP, applied on a consistent basis, and permit Lender to examine and audit Borrower's books and records at all reasonable times.

**Financial Statements.** Furnish Lender with the following:

**Additional Requirements.**

Annual internal financial statements of Landec Ag due within 120 days of Fiscal Year End.

Quarterly internal financial statements of Landec Ag due within 45 days of quarter end.

Annual and quarterly financial statements on guarantor (10-K and 10-Q).

All financial reports required to be provided under this Agreement shall be prepared in accordance with GAAP, applied on a consistent basis, and certified by Borrower as being true and correct.

**Additional Information.** Furnish such additional information and statements, as Lender may request from time to time.

**Financial Covenants and Ratios.** Comply with the following covenants and ratios:

**Other Requirements.**

Maintain a Minimum Cash Flow Coverage Ratio of 1.25x, tested annually at Fiscal Year End.

Cash Flow Coverage Ratio =  $\frac{\text{Net Income} + \text{Depr./Amort.} + \text{Interest Exp.} + \text{Mgmt. Fee Exp. accrued \& not paid} + \text{Interest Exp. on Sub. Debt accrued \& not paid} - \text{Cash Capex} - \text{Principal Payments on Long-Term Debt} - \text{Interest Expense Paid} - \text{Subordinated Debt Payments}}{\text{Cash Flow}}$

Corporate guaranty of Landec Corporation (parent) is required.

An annual 90-day clean-up is required.

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Except as provided above, all computations made to determine compliance with the requirements contained in this paragraph shall be made in accordance with generally accepted accounting principles, applied on a consistent basis, and certified by Borrower as being true and correct.

**Insurance.** Maintain fire and other risk insurance, public liability insurance, and such other insurance as Lender may require with respect to Borrower’s properties and operations, in form, amounts, coverages and with insurance companies acceptable to Lender. Borrower, upon request of Lender, will deliver to Lender from time to time the policies or certificates of insurance in form satisfactory to Lender, including stipulations that coverages will not be cancelled or diminished without at least ten (10) days prior written notice to Lender. Each insurance policy also shall include an endorsement providing that coverage in favor of Lender will not be impaired in any way by any act, omission or default of Borrower or any other person. In connection with all policies covering assets in which Lender holds or is offered a security interest for the Loans, Borrower will provide Lender with such lender’s loss payable or other endorsements as Lender may require.

**Insurance Reports.** Furnish to Lender, upon request of Lender, reports on each existing insurance policy showing such information as Lender may reasonably request, including without limitation the following: (1) the name of the insurer; (2) the risks insured; (3) the amount of the policy; (4) the properties insured; (5) the then current property values on the basis of which insurance has been obtained, and the manner of determining those values; and (6) the expiration date of the policy. In addition, upon request of Lender (however not more often than annually), Borrower will have an independent appraiser satisfactory to Lender determine, as applicable, the actual cash value or replacement cost of any Collateral. The cost of such appraisal shall be paid by Borrower.

**Guaranties.** Prior to disbursement of any Loan proceeds, furnish executed guaranties of the Loans in favor of Lender, executed by the guarantor named below, on Lender’s forms, and in the amount and under the conditions set forth in those guaranties.

|                          |               |
|--------------------------|---------------|
| <u>Name of Guarantor</u> | <u>Amount</u> |
| Landec Corporation       | Unlimited     |

**Subordination.** Prior to disbursement of any Loan proceeds, deliver to Lender a subordination agreement on Lender’s forms, executed by Borrower’s creditor named below, subordinating all of Borrower’s indebtedness to such creditor, or such lesser amount as may be agreed to by Lender in writing, and any security interests in collateral securing that indebtedness to the Loans and security interests of Lender.

|                         |                             |
|-------------------------|-----------------------------|
| <u>Name of Creditor</u> | <u>Total Amount of Debt</u> |
| Landec Corporation      | \$ 10,000,000.00            |

**Other Agreements.** Comply with all terms and conditions of all other agreements, whether now or hereafter existing, between Borrower and any other party and notify Lender immediately in writing of any default in connection with any other such agreements.

**Loan Proceeds.** Use all Loan proceeds solely for Borrower’s business operations, unless specifically consented to the contrary by Lender in writing.

**Taxes, Charges and Liens.** Pay and discharge when due all of its indebtedness and obligations, including without limitation all assessments, taxes, governmental charges, levies and liens, of every kind and nature, imposed upon Borrower or its properties, income, or profits, prior to the date on which penalties would attach, and all lawful claims that, if unpaid, might become a lien or charge upon any of Borrower’s properties, income, or profits.

**Performance.** Perform and comply, in a timely manner, with all terms, conditions, and provisions set forth in this Agreement, in the Related Documents, and in all other instruments and agreements between Borrower and Lender. Borrower shall notify Lender immediately in writing of any default in connection with any agreement.

**Operations.** Maintain executive and management personnel with substantially the same qualifications and experience as the present executive and management personnel; provide written notice to Lender of any change in executive and management personnel; conduct its business affairs in a reasonable and prudent manner.

**Environmental Studies.** Promptly conduct and complete, at Borrower’s expense, all such investigations, studies, samplings and testings as may be requested by Lender or any governmental authority relative to any substance, or any waste or by-



product of any substance defined as toxic or a hazardous substance under applicable federal, state, or local law, rule, regulation, order or directive, at or affecting any property or any facility owned, leased or used by Borrower.

**Compliance with Governmental Requirements.** Comply with all laws, ordinances, and regulations, now or hereafter in effect, of all governmental authorities applicable to the conduct of Borrower's properties, businesses and operations, and to the use or occupancy of the Collateral, including without limitation, the Americans With Disabilities Act. Borrower may contest in good faith any such law, ordinance, or regulation and withhold compliance during any proceeding, including appropriate appeals, so long as Borrower has notified Lender in writing prior to doing so and so long as, in Lender's sole opinion, Lender's interests in the Collateral are not jeopardized. Lender may require or rorer to post adequate security or a surety bond, reasonably satisfactory to Lender, to protect Lender's interest.

**Inspection:** Permit employees or agents of Lender at any reasonable time to inspect any and all Collateral for the Loan or Loans and Borrower's other properties and to examine or audit Borrower's books, accounts, and records and to make copies and memoranda of Borrower's books, accounts, and records. If Borrower now or at any time hereafter maintains any records (including without limitation computer generated records and computer software programs for the generation of such records) in the possession of a third party, Borrower, upon request of Lender, shall notify such party to permit Lender free access to such records at all reasonable times and to provide Lender with copies of any records it may request, all at Borrower's expense.

**Compliance Certificates.** Unless waived in writing by Lender, provide Lender at least annually, with a certificate executed by Borrower's chief financial officer, or other officer or person acceptable to Lender, certifying that the representations and warranties set forth in this Agreement are true and correct as of the date of the certificate and further certifying that, as of the date of the certificate, no Event of Default exists under this Agreement.

**Environmental Compliance and Reports.** Borrower shall comply in all respects with any and all Environmental Laws; not cause or permit to exist, as a result of an intentional or unintentional action or omission on Borrower's part or on the part of any third party, on property owned and/or occupied by Borrower, any environmental activity where damage may result to the environment, unless such environmental activity is pursuant to and in compliance with the conditions of a permit issued by the appropriate federal, state or local governmental authorities; shall furnish to Lender promptly and in any event within thirty (30) days after receipt thereof a copy of any notice, summons, lien, citation, directive, letter or other communication from any governmental agency or instrumentality concerning any intentional or unintentional action or omission on Borrower's part in connection with any environmental activity whether or not there is damage to the environment and/or other natural resources.

**Additional Assurances.** Make, execute and deliver to Lender such promissory notes, mortgages, deeds of trust, security agreements, assignments, financing statements, instruments, documents and other agreements as Lender or its attorneys may reasonably request to evidence and secure the Loans and to perfect all Security Interests.

**RECOVERY OF ADDITIONAL COSTS.** If the imposition of or any change in any law, rule, regulation or guideline, or the interpretation or application of any thereof by any court or administrative or governmental authority (including any request or policy not having the force of law) shall impose, modify or make applicable any taxes (except federal, state or local income or franchise taxes imposed on Lender), reserve requirements, capital adequacy requirements or other obligations which would (A) increase the cost to Lender for extending or maintaining the credit facilities to which this Agreement relates, (B) reduce the amounts payable to Lender under this Agreement or the Related Documents, or (C) reduce the rate of return on Lender's capital as a consequence of Lender's obligations with respect to the credit facilities to which this Agreement relates, then Borrower agrees to pay Lender such additional amounts as will compensate Lender therefor, within five (5) days after Lender's written demand for such payment, which demand shall be accompanied by an explanation of such imposition or charge and a calculation in reasonable detail of the additional amounts payable by Borrower, which explanation and calculations shall be conclusive in the absence of manifest error.

**LENDER'S EXPENDITURES.** If any action or proceeding is commenced that would materially affect Lender's interest in the Collateral or if Borrower fails to comply with any provision of this Agreement or any Related Documents, including but not limited to Borrower's failure to discharge or pay when due any amounts Borrower is required to discharge or pay under this Agreement or any Related Documents, Lender on Borrower's behalf may (but shall not be obligated to) take any action that Lender deems appropriate, including but not limited to discharging or paying all taxes, liens, security interests, encumbrances and other claims, at any time levied or placed on any Collateral and paying all costs for insuring, maintaining and preserving any Collateral. All such expenditures incurred or paid by Lender for such purposes will then bear interest at the rate charged under the Note from the date incurred or paid by Lender to the date of repayment by Borrower. All such expenses will become a part of the indebtedness and, at Lender's option, will (A) be payable on demand; (B) be added to the balance of the Note and be apportioned among and be payable with any

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installment payments to become due during either (1) the term of any applicable insurance policy; or (2) the remaining term of the Note; or (C) be treated as a balloon payment which will be due and payable at the Note's maturity.

**NEGATIVE COVENANTS.** Borrower covenants and agrees with Lender that while this Agreement is in effect, Borrower shall not, without the prior written consent of Lender:

**Indebtedness and Liens.** (1) Except for trade debt incurred in the normal course of business and indebtedness to Lender contemplated by this Agreement, create, incur or assume indebtedness for borrowed money, including capital leases, (2) sell, transfer, mortgage, assign, pledge, lease, grant a security interest in, or encumber any of Borrower's assets (except as allowed as Permitted Liens), or (3) sell with recourse any of Borrower's accounts, except to Lender.

**Continuity of Operations.** (1) Engage in any business activities substantially different than those in which Borrower is presently engaged, (2) cease operations, liquidate, merge, transfer, acquire or consolidate with any other entity, change its name, dissolve or transfer or sell Collateral out of the ordinary course of business, or (3) pay any dividends on Borrower's stock (other than dividends payable in its stock), provided, however that notwithstanding the foregoing, but only so long as no Event of Default has occurred and is continuing or would result from the payment of dividends, if Borrower is a "Subchapter S Corporation" (as defined in the Internal Revenue Code of 1986, as amended), Borrower may pay cash dividends on its stock to its shareholders from time to time in amounts necessary to enable the shareholders to pay income taxes and make estimated income tax payments to satisfy their liabilities under federal and state law which arise solely from their status as Shareholders of a Subchapter S Corporation because of their ownership of shares of Borrower's stock, or purchase or retire any of Borrower's outstanding shares or alter or amend Borrower's capital structure.

**Loans, Acquisitions and Guaranties.** (1) Loan, invest in or advance money or assets to any other person, enterprise or entity, (2) purchase, create or acquire any interest in any other enterprise or entity, or (3) incur any obligation as surety or guarantor other than in the ordinary course of business.

**Agreements.** Borrower will not enter into any agreement containing any provisions which would be violated or breached by the performance of Borrower's obligations under this Agreement or in connection herewith.

**CESSATION OF ADVANCES.** If Lender has made any commitment to make any Loan to Borrower, whether under this Agreement or under any other agreement, Lender shall have no obligation to make Loan Advances or to disburse Loan proceeds if: (A) Borrower or any Guarantor is in default under the terms of this Agreement or any of the Related Documents or any other agreement that Borrower or any Guarantor has with Lender; (B) Borrower or any Guarantor dies, becomes incompetent or becomes insolvent, files a petition in bankruptcy or similar proceedings, or is adjudged a bankrupt; (C) there occurs a material adverse change in Borrower's financial condition, in the financial condition of any Guarantor, or in the value of any Collateral securing any Loan; or (D) any Guarantor seeks, claims or otherwise attempts to limit, modify or revoke such Guarantor's guaranty of the Loan or any other loan with Lender; or (E) Lender in good faith deems itself insecure, even though no Event of Default shall have occurred.

**RIGHT OF SETOFF.** To the extent permitted by applicable law, Lender reserves a right of setoff in all Borrower's accounts with Lender (whether checking, savings, or some other account). This includes all accounts Borrower holds jointly with someone else and all accounts Borrower may open in the future. However, this does not include any IRA or Keogh accounts, or any trust accounts for which setoff would be prohibited by law. Borrower authorizes Lender, to the extent permitted by applicable law, to charge or setoff all sums owing on the indebtedness against any and all such accounts, and, at Lender's option, to administratively freeze all such accounts to allow Lender to protect Lender's charge and setoff rights provided in this paragraph.

**DEFAULT.** Each of the following shall constitute an Event of Default under this Agreement:

**Payment Default.** Borrower fails to make any payment when due under the Loan.

**Other Defaults.** Borrower fails to comply with or to perform any other term, obligation, covenant or condition contained in this Agreement or in any of the Related Documents or to comply with or to perform any term, obligation, covenant or condition contained in any other agreement between Lender and Borrower.

**Default in Favor of Third Parties.** Borrower or any Grantor defaults under any loan, extension of credit, security agreement, purchase or sales agreement, or any other agreement, in favor of any other creditor or person that may materially affect any of Borrower's or any Grantor's property or Borrower's or any Grantor's ability to repay the Loans or perform their respective obligations under this Agreement or any of the Related Documents.

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**False Statements.** Any warranty, representation or statement made or furnished to Lender by Borrower or on Borrower's behalf under this Agreement or the Related Documents is false or misleading in any material respect, either now or at the time made or furnished or becomes false or misleading at any time thereafter.

**Insolvency.** The dissolution or termination of Borrower's existence as a going business, the insolvency of Borrower, the appointment of a receiver for any part of Borrower's property, any assignment for the benefit of creditors, any type of creditor workout, or the

**Defective Collateralization .** This Agreement or any of the Related Documents ceases to be in full force and effect (including failure of any collateral document to create a valid and perfected security interest or lien) at any time and for any reason.

**Creditor or Forfeiture Proceedings.** Commencement of foreclosure or forfeiture proceedings, whether by judicial proceeding, self-help, repossession or any other method, by any creditor of Borrower or by any governmental agency against any collateral securing the Loan. This includes a garnishment of any of Borrower's accounts, including deposit accounts, with Lender. However, this Event of Default shall not apply if there is a good faith dispute by Borrower as to the validity or reasonableness of the claim which is the basis of the creditor or forfeiture proceeding and if Borrower gives Lender written notice of the creditor or forfeiture proceeding and deposits with Lender monies or a surety bond for the creditor or forfeiture proceeding, in an amount determined by Lender, in its sole discretion, as being an adequate reserve or bond for the dispute.

**Events Affecting Guarantor.** Any of the preceding events occurs with respect to any Guarantor of any of the Indebtedness or any Guarantor dies or becomes incompetent, or revokes or disputes the validity of, or liability under, any Guaranty of the Indebtedness. In the event of a death, Lender, at its option, may, but shall not be required to, permit the Guarantor's estate to assume unconditionally the obligations arising under the guaranty in a manner satisfactory to Lender, and, in doing so, cure any Event of Default.

**Change in Ownership.** Any change in ownership of twenty-five percent (25%) or more of the common stock of Borrower.

**Adverse Change.** A material adverse change occurs in Borrower's financial condition, or Lender believes the prospect of payment or performance of the Loan is impaired.

**Insecurity.** Lender in good faith believes itself insecure.

**Right to Cure.** If any default, other than a default on Indebtedness, is curable and if Borrower or Grantor, as the case may be, has not been given a notice of a similar default within the preceding twelve (12) months, it may be cured if Borrower or Grantor, as the case may be, after receiving written notice from Lender demanding cure of such default: (1) cure the default within fifteen (15) days; or (2) if the cure requires more than fifteen (15) days, immediately initiate steps which Lender deems in Lender's sole discretion to be sufficient to cure the default and thereafter continue and complete all reasonable and necessary steps sufficient to produce compliance as soon as reasonably practical.

**EFFECT OF AN EVENT OF DEFAULT.** If any Event of Default shall occur, except where otherwise provided in this Agreement or the Related Documents, all commitments and obligations of Lender under this Agreement or the Related Documents or any other agreement immediately will terminate (including any obligation to make further Loan Advances or disbursements), and, at Lender's option, all indebtedness immediately will become due and payable, all without notice of any kind to Borrower, except that in the case of an Event of Default of the type described in the "Insolvency" subsection above, such acceleration shall be automatic and not optional. In addition, Lender shall have all the rights and remedies provided in the Related Documents or available at law, in equity, or otherwise. Except as may be prohibited by applicable law, all of Lender's rights and remedies shall be cumulative and may be exercised singularly or concurrently. Election by Lender to pursue any remedy shall not exclude pursuit of any other remedy, and an election to make expenditures or to take action to perform an obligation of Borrower or of any Grantor shall not affect Lender's right to declare a default and to exercise its rights and remedies. All Loans shall be repaid under all circumstances without relief from any Indiana or other valuation and appraisal laws.

**MISCELLANEOUS PROVISIONS.** The following miscellaneous provisions are a part of this Agreement:

**Amendments.** This Agreement, together with any Related Documents, constitutes the entire understanding and agreement of the parties as to the matters set forth in this Agreement. No alteration of or amendment to this Agreement shall be effective unless given in writing and signed by the party or parties sought to be charged or bound by the alteration or amendment.

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**Attorneys' Fees; Expenses.** Borrower agrees to pay upon demand all of Lender's costs and expenses, including Lender's attorneys' fees and Lender's legal expenses, incurred in connection with the enforcement of this Agreement. Lender may hire or pay someone else to help enforce this Agreement, and Borrower shall pay the costs and expenses of such enforcement. Costs and expenses include Lender's attorneys' fees and legal expenses whether or not there is a lawsuit, including attorneys' fees and legal expenses for bankruptcy proceedings (including efforts to modify or vacate any automatic stay or injunction), appeals, and any anticipated post-judgment collection services. Borrower also shall pay all court costs and such additional fees as may be directed by the court.

**Caption Headings.** Caption headings in this Agreement are for convenience purposes only and are not to be used to interpret or define the provisions of this Agreement.

**Consent to Loan Participation.** Borrower agrees and consents to Lender's sale or transfer, whether now or later, of one or more participation interests in the Loan to one or more purchasers, whether related or unrelated to Lender. Lender may provide, without any limitation whatsoever, to any one or more purchasers, or potential purchasers, any information or knowledge Lender may have about Borrower or about any other matter relating to the Loan, and Borrower hereby waives any rights to privacy Borrower may have with respect to such matters. Borrower additionally waives any and all notices of sale of participation interests, as well as all notices of any repurchase of such participation interests. Borrower also agrees that the purchasers of any such participation interests will be considered as the absolute owners of such interests in the Loan and will have all the rights granted under the participation agreement or agreements governing the sale of such participation interests. Borrower further waives all rights of offset or counterclaim that it may have now or later against Lender or against any purchaser of such a participation interest and unconditionally agrees that either Lender or such purchaser may enforce Borrower's obligation under the Loan irrespective of the failure or insolvency of any holder of any interest in the Loan. Borrower further agrees that the purchaser of any such participation interests may enforce its interests irrespective of any personal claims or defenses that Borrower may have against Lender.

**Governing Law.** This Agreement will be governed by federal law applicable to Lender and, to the extent not preempted by federal law, the laws of the State of Indiana without regard to its conflicts of law provisions. This Agreement has been accepted by Lender in the State of Indiana.

**Choice of Venue.** If there is a lawsuit, Borrower agrees upon Lender's request to submit to the jurisdiction of the courts of MARION County, State of Indiana.

**No Waiver by Lender.** Lender shall not be deemed to have waived any rights under this Agreement unless such waiver is given in writing and signed by Lender. No delay or omission on the part of Lender in exercising any right shall operate as a waiver of such right or any other right. A waiver by Lender of a provision of this Agreement shall not prejudice or constitute a waiver of Lender's right otherwise to demand strict compliance with that provision or any other provision of this Agreement. No prior waiver by Lender, nor any course of dealing between Lender and Borrower, or between Lender and any Grantor, shall constitute a waiver of any of Lender's rights or of any of Borrower's or any Grantor's obligations as to any future transactions. Whenever the consent of Lender is required under this Agreement, the granting of such consent by Lender in any instance shall not constitute continuing consent to subsequent instances where such consent is required and in all cases such consent may be granted or withheld in the sole discretion of Lender.

**Notices.** Any notice required to be given under this Agreement shall be given in writing, and shall be effective when actually delivered, when actually received by telefacsimile (unless otherwise required by law), when deposited with a nationally recognized overnight courier, or, if mailed, when deposited in the United States mail, as first class, certified or registered mail postage prepaid, directed to the addresses shown near the beginning of this Agreement. Any party may change its address for notices under this Agreement by giving formal written notice to the other parties, specifying that the purpose of the notice is to change the party's address. For notice purposes, Borrower agrees to keep Lender informed at all times of Borrower's current address. Unless otherwise provided or required by law, if there is more than one Borrower, any notice given by Lender to any Borrower is deemed to be notice given to all Borrowers.

**Severability.** If a court of competent jurisdiction finds any provision of this Agreement to be illegal, invalid, or unenforceable as to any circumstance, that finding shall not make the offending provision illegal, invalid, or unenforceable as to any other circumstance. If feasible, the offending provision shall be considered modified so that it becomes legal, valid and enforceable. If the offending provision cannot be so modified, it shall be considered deleted from this Agreement. Unless otherwise required by law, the illegality, invalidity, or unenforceability of any provision of this Agreement shall not affect the legality, validity or enforceability of any other provision of this Agreement.

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**Subsidiaries and Affiliates of Borrower.** To the extent the context of any provisions of this Agreement makes it appropriate, including without limitation any representation, warranty or covenant, the word "Borrower" as used in this Agreement shall include all of Borrower's subsidiaries and affiliates. Notwithstanding the foregoing however, under no circumstances shall this Agreement be construed to require Lender to make any Loan or other financial accommodation to any of Borrower's subsidiaries or affiliates.

**Successors and Assigns.** All covenants and agreements by or on behalf of Borrower contained in this Agreement or any Related Documents shall bind Borrower's successors and assigns and shall inure to the benefit of Lender and its successors and assigns. Borrower shall not, however, have the right to assign Borrower's rights under this Agreement or any interest therein, without the prior written consent of Lender.

**Survival of Representations and Warranties.** Borrower understands and agrees that in extending Loan Advances, Lender is relying on all representations, warranties, and covenants made by Borrower in this Agreement or in any certificate or other instrument delivered by Borrower to Lender under this Agreement or the Related Documents. Borrower further agrees that regardless of any investigation made by Lender, all such representations, warranties and covenants will survive the extension of Loan Advances and delivery to Lender of the Related Documents, shall be continuing in nature, shall be deemed made and redated by Borrower at the time each Loan Advance is made, and shall remain in full force and effect until such time as Borrower's indebtedness shall be paid in full, or until this Agreement shall be terminated in the manner provided above, whichever is the last to occur.

**Time is of the Essence.** Time is of the essence in the performance of this Agreement.

**Waive Jury.** All parties to this Agreement hereby waive the right to any jury trial in any action, proceeding, or counterclaim brought by any party against any other party.

**DEFINITIONS.** The following capitalized words and terms shall have the following meanings when used in this Agreement. Unless specifically stated to the contrary, all references to dollar amounts shall mean amounts in lawful money of the United States of America. Words and terms used in the singular shall include the plural, and the plural shall include the singular, as the context may require. Words and terms not otherwise defined in this Agreement shall have the meanings attributed to such terms in the Uniform Commercial Code. Accounting words and terms not otherwise defined in this Agreement shall have the meanings assigned to them in accordance with generally accepted accounting principles as in effect on the date of this Agreement:

**Advance.** The word "Advance" means a disbursement of Loan funds made, or to be made, to Borrower or on Borrower's behalf on a line of credit or multiple advance basis under the terms and conditions of this Agreement.

**Agreement.** The word "Agreement" means this Business Loan Agreement, as this Business Loan Agreement may be amended or modified from time to time, together with all exhibits and schedules attached to this Business Loan Agreement from time to time.

**Borrower.** The word "Borrower" means Landec Ag, Inc. and includes all co-signers and co-makers signing the Note and all their successors and assigns.

**Collateral.** The word "Collateral" means all property and assets granted as collateral security for a Loan, whether real or personal property, whether granted directly or indirectly, whether granted now or in the future, and whether granted in the form of a security interest, mortgage, collateral mortgage, deed of trust, assignment, pledge, crop pledge, chattel mortgage, collateral chattel mortgage, chattel trust, factor's lien, equipment trust, conditional sale, trust receipt, lien, charge, lien or title retention contract, lease or consignment intended as a security device, or any other security or lien interest whatsoever, whether created by law, contract, or otherwise.

**Environmental Laws.** The words "Environmental Laws" mean any and all state, federal and local statutes, regulations and ordinances relating to the protection of human health or the environment, including without limitation the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended, 42 U.S.C. Section 9601, et seq. ("CERCLA"), the Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499 ("SARA"), the Hazardous Materials Transportation Act, 49 U.S.C. Section 1801, et seq., the Resource Conservation and Recovery Act, 42 U.S.C. Section 6901, et seq., or other applicable state or federal laws, rules, or regulations adopted pursuant thereto.

**Event of Default.** The words "Event of Default" mean any of the events of default set forth in this Agreement in the default section of this Agreement.

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**GAAP.** The word “GAAP” means generally accepted accounting principles.

**Grantor.** The word “Grantor” means each and all of the persons or entities granting a Security Interest in any Collateral for the Loan, including without limitation all Borrowers granting such a Security Interest.

**Guarantor.** The word “Guarantor” means any guarantor, surety, or accommodation party of any or all of the Loan.

**Guaranty .** The word “Guaranty” means the guaranty from Guarantor to Lender, including without limitation a guaranty of all or part of the Note.

**Hazardous Substances.** The words “Hazardous Substances” mean materials that, because of their quantity, concentration or physical, chemical or infectious characteristics, may cause or pose a present or potential hazard to human health or the environment when improperly used, treated, stored, disposed of, generated, manufactured, transported or otherwise handled. The words “Hazardous Substances” are used in their very broadest sense and include without limitation any and all hazardous or toxic substances, materials or waste as defined by or listed under the Environmental Laws. The term “Hazardous Substances” also includes, without limitation, petroleum and petroleum by-products or any fraction thereof and asbestos.

**Indebtedness.** The word “Indebtedness” means the indebtedness evidenced by the Note or Related Documents, including all principal and interest together with all other indebtedness and costs and expenses for which Borrower is responsible under this Agreement or under any of the Related Documents.

**Lender.** The word “Lender” means OLD NATIONAL BANK, its successors and assigns.

**Loan.** The word “Loan” means any and all loans and financial accommodations from Lender to Borrower whether now or hereafter existing, and however evidenced, including without limitation those loans and financial accommodations described herein or described on any exhibit or schedule attached to this Agreement from time to time.

**Note.** The word “Note” means the Note executed by Landec Ag, Inc. in the principal amount of \$10,000,000.00 dated August 29, 2006, together with all renewals of, extensions of, modifications of, refinancings of, consolidations of, and substitutions for the note or credit agreement.

**Permitted Liens.** The words “Permitted Liens” mean (1) liens and security interests securing indebtedness owed by Borrower to Lender; (2) liens for taxes, assessments, or similar charges either not yet due or being contested in good faith; (3) liens of materialmen, mechanics, warehousemen, or carriers, or other like liens arising in the ordinary course of business and securing obligations which are not yet delinquent; (4) purchase money liens or purchase money security interests upon or in any property acquired or held by Borrower in the ordinary course of business to secure indebtedness outstanding on the date of this Agreement or permitted to be incurred under the paragraph of this Agreement titled “Indebtedness and Liens”; (5) liens and security interests which, as of the date of this Agreement, have been disclosed to and approved by the Lender in writing; and (6) those liens and security interests which in the aggregate constitute an immaterial and insignificant monetary amount with respect to the net value of Borrower’s assets.

**Related Documents.** The words “Related Documents” mean all promissory notes, credit agreements, loan agreements, environmental agreements, guaranties, security agreements, mortgages, deeds of trust, security deeds, collateral mortgages, and all other instruments, agreements and documents, whether now or hereafter existing, executed in connection with the Loan.

**Security Agreement.** The words “Security Agreement” mean and include without limitation any agreements, promises, covenants, arrangements, understandings or other agreements, whether created by law, contract, or otherwise, evidencing, governing, representing, or creating a Security Interest.

**Security Interest.** The words “Security Interest” mean, without limitation, any and all types of collateral security, present and future, whether in the form of a lien, charge, encumbrance, mortgage, deed of trust, security deed, assignment, pledge, crop pledge, chattel mortgage, collateral chattel mortgage, chattel trust, factor’s lien, equipment trust, conditional sale, trust receipt, lien or title retention contract, lease or consignment intended as a security device, or any other security or lien interest whatsoever whether created by law, contract, or otherwise.

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**BORROWER ACKNOWLEDGES HAVING READ ALL THE PROVISIONS OF THIS BUSINESS LOAN AGREEMENT AND BORROWER AGREES TO ITS TERMS. THIS BUSINESS LOAN AGREEMENT IS DATED AUGUST 29, 2006.**

**BORROWER:**

**LANDEC AG, INC.**

By: \_\_\_\_\_  
Michael E. Godlove, Chief Financial Officer of  
Landec Ag, Inc.

**LENDER:**

**OLD NATIONAL BANK**

By: \_\_\_\_\_  
Authorized Signer





CERTIFICATION

I, Gary T. Steele, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Landec Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation, and
  - (d) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 29, 2006

/s/ Gary T. Steele

Gary T. Steele  
Chief Executive Officer



## CERTIFICATION

I, Gregory S. Skinner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Landec Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles ;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - (d) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 29, 2006

/s/ Gregory S. Skinner

Gregory S. Skinner  
Chief Financial Officer



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

In connection with the Quarterly Report of Landec Corporation (the "Company") on Form 10-Q for the period ending August 27, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gary T. Steele, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: September 29, 2006

/s/ Gary T. Steele

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

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



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

In connection with the Quarterly Report of Landec Corporation (the "Company") on Form 10-Q for the period ending August 27, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gregory S. Skinner, Vice President of Finance and Administration and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: September 29, 2006

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

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