

LANDEC CORP \CA\  
Form 10-Q  
January 05, 2017

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United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

[X]

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

**For the Fiscal Quarter Ended November 27, 2016, or**

[ ]

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

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

Commission file number: **0-27446**

**LANDEC CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

**94-3025618**

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification Number)

**3603 Haven Avenue**

**Menlo Park, California 94025**

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code:

**(650) 306-1650**

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

Yes  No

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

Yes  No

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

Large Accelerated Filer

Accelerated Filer

Non Accelerated Filer

Smaller Reporting Company

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

Yes  No

As of December 22, 2016, there were 27,270,832 shares of Common Stock outstanding.

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**LANDEC CORPORATION**

FORM 10-Q

For the Fiscal Quarter Ended November 27, 2016

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**LANDEC CORPORATION**

**CONSOLIDATED BALANCE SHEETS**

**(In thousands except par value)**

November 27, 2016

May 29, 2016

(unaudited)

As Adjusted (1)

**ASSETS**

Current Assets:

Cash and cash equivalents

\$ 2,566    \$ 9,894

Accounts receivable, less allowance for doubtful accounts

50,009    46,406

Inventories

27,970 25,535

Prepaid expenses and other current assets

3,930 4,468

Total Current Assets

84,475 86,303

Investment in non-public company, fair value

62,700 62,700

Property and equipment, net

120,972 120,880

Goodwill, net

49,620 49,620

Trademarks/tradenames, net

14,428 14,428

Customer relationships, net

6,525 6,968

Other assets

2,621 1,754

Total Assets

\$ 341,341 \$ 342,653

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Current Liabilities:

Accounts payable

\$ 25,914 \$ 30,904

Accrued compensation

5,696	5,460
Other accrued liabilities	
8,424	7,772
Deferred revenue	
474	832
Lines of credit	
1,500	3,500
Current portion of long-term debt, net	
4,940	7,873
Total Current Liabilities	
46,948	56,341
Long-term debt, net	
44,771	45,972
Capital lease obligation, less current portion	
3,770	3,804
Deferred taxes, net	
24,328	22,442
Other non-current liabilities	
1,977	1,744
Total Liabilities	
121,794	130,303
Stockholders' Equity:	
Common stock, \$0.001 par value; 50,000 shares authorized; 27,258 and 27,148 shares issued and outstanding at November 27, 2016 and May 29, 2016, respectively	
27	27

Additional paid-in capital

139,138    137,244

Retained earnings

78,518    73,457

Accumulated other comprehensive income

327    —

Total Stockholders' Equity

218,010    210,728

Non-controlling interest

1,537    1,622

Total Equity

219,547    212,350

Total Liabilities and Stockholders' Equity

\$ 341,341    \$ 342,653

(1) Derived from audited financial statements. See Note 1 – Organization, Basis of Presentation, and Summary of Significant Accounting Policies for discussion of accounting guidance adopted during the period.

*See accompanying notes.*

**LANDEC CORPORATION**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

**(In thousands, except per share amounts)**

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

November 27, 2016

November 29, 2015

Product sales

\$ 135,865	\$ 140,441	\$ 268,259	\$ 275,796
------------	------------	------------	------------

Cost of product sales

116,912	123,176	228,162	240,554
---------	---------	---------	---------

Gross profit

18,953	17,265	40,097	35,242
--------	--------	--------	--------

Operating expenses:

Research and development

1,965 1,643 3,903 3,518

Selling, general and administrative

13,724 12,815 27,460 24,979

Total operating costs and expenses

15,689 14,458 31,363 28,497

Operating income

3,264 2,807 8,734 6,745

Dividend income

413 413 825 825

Interest income

3 16 7 47

Interest expense

(380

)

(439

)

(1,032

)

(941

)

Loss on debt refinancing

(1,233

)

— (1,233  
 )

—

Other income

— 200 — 1,000

Net income before taxes

2,067 2,997 7,301 7,676

Income tax expense

(693

)

(1,069

)

(2,582

)

(2,760

)

Consolidated net income

1,374 1,928 4,719 4,916

Non-controlling interest expense

(48

)

(60

)

(81

)

(96



)

Net income and comprehensive income applicable to common stockholders

\$ 1,326	\$ 1,868	\$ 4,638	\$ 4,820
----------	----------	----------	----------

Basic net income per share

\$ 0.05	\$ 0.07	\$ 0.17	\$ 0.18
---------	---------	---------	---------

Diluted net income per share

\$ 0.05	\$ 0.07	\$ 0.17	\$ 0.18
---------	---------	---------	---------

Shares used in per share computation

Basic

27,249	27,021	27,234	27,013
--------	--------	--------	--------

Diluted

27,618	27,420	27,572	27,417
--------	--------	--------	--------

Other comprehensive income, net of tax:

Change in net unrealized gains on interest rate swap (net of tax effect of \$192, \$0, \$192, and \$0)

\$ 327	\$ —	\$ 327	\$ —
--------	------	--------	------

Other comprehensive income, net of tax

327	—	327	—
-----	---	-----	---

Total comprehensive income

\$ 1,653	\$ 1,868	\$ 4,965	\$ 4,820
----------	----------	----------	----------

*See accompanying notes.*

**LANDEC CORPORATION**

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

**(Unaudited)**

**(in thousands, except per share amounts)**

Common Stock

Additional Paid-in

Retained

Accumulated Other Comprehensive

Total Stockholders'

Non-controlling

Shares

Amount

Capital

Earnings

Income

Equity

Interest

Balance at May 29, 2016

27,148    \$ 27    \$ 137,244    \$ 73,457    \$ —    \$ 210,728    \$ 1,622

Cumulative-effect adjustment - ASU 2016-09 adoption (1)

—    —    200    423    —    623    —

Issuance of common stock at \$5.63 to \$6.66 per share, net of taxes paid by Landec on behalf of employees

40    —    193    —    —    193    —

Issuance of common stock for vested restricted stock units (“RSUs”)

70    —    —    —    —    —    —

Taxes paid by Company for stock swaps and RSUs

—    —    (272

)

—    —    (272

)

—

Stock-based compensation

—    —    1,773    —    —    1,773    —

Payments to non-controlling interest

—    —    —    —    —    —    (166

)

Net income

— — — 4,638 — 4,638 81

Other comprehensive income, net of tax

— — — — 327 327 —

Balance at November 27, 2016

27,258 \$ 27 \$ 139,138 \$ 78,518 \$ 327 \$ 218,010 \$ 1,537

(1)

See Note 1 – Organization, Basis of Presentation, and Summary of Significant Accounting Policies for a discussion of accounting guidance adopted during the period.

*See accompanying notes.*

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**LANDEC CORPORATION**

**Consolidated Statements of Cash Flows**

**(Unaudited)**

**(In thousands)**

Six Months Ended

November 27, 2016

November 29, 2015

As Adjusted (1)

Cash flows from operating activities:

Consolidated net income

\$ 4,719    \$ 4,916

Adjustments to reconcile net income to net cash provided by operating activities:

Depreciation and amortization

5,110    4,339

Stock-based compensation expense

1,773    1,697

Deferred taxes

2,317 1,167

Loss on early debt extinguishment

1,233 —

Change in investment in non-public company, fair value

— (1,000

)

Net loss on disposal of property and equipment

57 —

Changes in current assets and current liabilities:

Accounts receivable, net

(3,603

)

(3,804

)

Inventories, net

(2,435

)

(3,832

)

Prepaid expenses and other current assets

666 (2,464

)

Accounts payable

(4,990

)

1,912

Accrued compensation

236 (1,359

)

Other accrued liabilities

802 1,172

Deferred revenue, net

(358

)

(462

)

Net cash provided by operating activities

5,527 2,282

Cash flows from investing activities:

Purchases of property and equipment

(4,738

)

(15,203

)

Deposit on capital lease

— (850

)

Proceeds from sales of fixed assets

14 91

Net cash used in investing activities

(4,724

)

(15,962

)

Cash flows from financing activities:

Proceeds from sale of common stock

193 108

Taxes paid by Company for stock swaps and RSUs

(272

)

—

Proceeds from long-term debt

50,000 9,972

Payments on long-term debt

(54,697

)

(4,278

)

Proceeds from lines of credit

1,500 10,500

Payments on line of credit

(3,500

)



(10,500

)

Payments for debt issuance costs

(897

)

—

Payments for early debt extinguishment penalties

(233

)

—

Change in other assets

(59

)

(26

)

Payments to non-controlling interest

(166

)

(248

)

Net cash provided by (used in) financing activities

(8,131

)

5,528

Net decrease in cash and cash equivalents

(7,328

)

(8,152

)

Cash and cash equivalents at beginning of period

9,894 14,127

Cash and cash equivalents at end of period

\$ 2,566 \$ 5,975

(1)

See Note 1 – Organization, Basis of Presentation, and Summary of Significant Accounting Policies for a discussion of accounting principles adopted during the period.

*See accompanying notes.*

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## **LANDEC CORPORATION**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

#### **1.**

#### **Organization, Basis of Presentation, and Summary of Significant Accounting Policies**

##### **Organization**

Landec Corporation and its subsidiaries (“Landec” or the “Company”) design, develop, manufacture, and sell differentiated products for food and biomaterials markets, and license technology applications to partners. The Company has two proprietary polymer technology platforms: 1) Intelimer® polymers, and 2) hyaluronan (“HA”) biopolymers. The Company sells specialty packaged branded Eat Smart® and GreenLine® and private label fresh-cut vegetables and whole produce to retailers, club stores, and foodservice operators, primarily in the United States, Canada, and Asia through its Apio, Inc. (“Apio”) subsidiary, and sells HA-based and non-HA biomaterials through its Lifecore Biomedical, Inc. (“Lifecore”) subsidiary. The Company’s HA biopolymers and non-HA materials are proprietary in that they are specially formulated for specific customers to meet strict regulatory requirements. The Company’s technologies, along with its customer relationships and tradenames, are the foundation, and a key differentiating advantage upon which Landec has built its business.

##### **Basis of Presentation**

The accompanying unaudited consolidated financial statements of Landec have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made which are necessary to present fairly the financial position at November 27, 2016 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 U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted in accordance with 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 29, 2016.

The results of operations for the six months ended November 27, 2016 are not necessarily indicative of the results that may be expected for an entire fiscal year because there is some seasonality in Apio's food business, particularly, Apio's export business, and the order patterns of Lifecore's customers which may lead to significant fluctuations in Landec's quarterly results of operations.

### **Basis of Consolidation**

The consolidated financial statements are presented on the accrual basis of accounting in accordance with GAAP and include the accounts of Landec Corporation and its subsidiaries, Apio and Lifecore. All intercompany transactions and balances have been eliminated.

Arrangements that are not controlled through voting or similar rights are reviewed under the guidance for variable interest entities ("VIEs"). A company is required to consolidate the assets, liabilities, and operations of a VIE if it is determined to be the primary beneficiary of the VIE.

An entity is a VIE and subject to consolidation, if by design: a) the total equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by any party, including equity holders, or b) as a group the holders of the equity investment at risk lack any one of the following three characteristics: (i) the power, through voting rights or similar rights to direct the activities of an entity that most significantly impact the entity's economic performance, (ii) the obligation to absorb the expected losses of the entity, or (iii) the right to receive the expected residual returns of the entity. The Company reviewed the consolidation guidance and concluded that its partnership interest in Apio Cooling, LP (see below) and its equity investment in the non-public company (see Note 2) are not VIEs.

## **Use of Estimates**

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

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

## **Cash and Cash Equivalents**

The Company records all highly liquid securities with three months or less from date of purchase to maturity as cash equivalents. Cash equivalents consist mainly of money market funds. The market value of cash equivalents approximates their historical cost given their short-term nature.

## **Debt Issuance Costs**

The Company records its line of credit debt issuance costs as an asset, and as such, \$120,000 and \$459,000 was recorded as prepaid expenses and other current assets and other assets, respectively, as of November 27, 2016. The Company records its term debt issuance costs as a contra-liability, and as such, \$60,000 and \$229,000 was recorded as current portion of long-term debt and long-term debt, respectively, as of November 27, 2016 (see Note 7).

## **Financial Instruments**

The Company's financial instruments are primarily composed of commercial-term trade payables, grower advances, notes receivable, and debt instruments. For short-term instruments, the historical carrying amount approximates the fair value of the instrument. The fair value of long-term debt approximates its carrying value.

### *Cash Flow Hedges*

The Company entered into an interest rate swap agreement to manage interest rate risk. This derivative instrument may offset a portion of the changes in interest expense. The Company designates this derivative instrument as a cash flow hedge. The Company accounts for its derivative instrument as either an asset or a liability and carries it at fair value in Other assets or Other non-current liabilities. The accounting for changes in the fair value of the derivative instrument depends on the intended use of the derivative instrument and the resulting designation.

For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of Accumulated Other Comprehensive Income in Stockholders' Equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument, if any, is recognized in earnings in the current period. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions.

For additional information refer to Note 10 – Comprehensive Income.

### **Investment in Non-Public Company**

On February 15, 2011, Apio purchased 150,000 senior preferred shares for \$15 million and 201 common shares for \$201 that were issued by Windset Holdings 2010 Ltd., a Canadian corporation (“Windset”). On July 15, 2014, Apio increased its investment in Windset by purchasing an additional 68 shares of common stock and 51,211 shares of junior preferred stock of Windset for \$11 million. On October 29, 2014, Apio purchased an additional 70,000 senior preferred shares of Windset for \$7 million. These investments are reported as an investment in non-public company, fair value, in the accompanying Consolidated Balance Sheets as of November 27, 2016 and May 29, 2016. The Company has elected to account for its investment in Windset under the fair value option (see Note 2).

## **Intangible Assets**

The Company's intangible assets are comprised of customer relationships with a finite estimated useful life of twelve to thirteen years, and trademarks, tradenames and goodwill with indefinite lives.

Finite-lived intangible assets are reviewed for possible impairment whenever events or changes in circumstances occur that indicate that the carrying amount of an asset (or asset group) may not be recoverable. Indefinite lived intangible assets are reviewed for impairment at least annually. For goodwill and other indefinite-lived intangible assets, the Company performs a qualitative impairment analysis in accordance with Accounting Standards Codification ("ASC") 350-30-35.

## **Partial Self-Insurance on Employee Health and Workers Compensation Plans**

The Company provides health insurance benefits to eligible employees under self-insured plans whereby the Company pays actual medical claims subject to certain stop loss limits and self-insures its workers compensation claims. The Company records self-insurance liabilities based on actual claims filed and an estimate of those claims incurred but not reported. Any projection of losses concerning the Company's liability is subject to a high degree of variability. Among the causes of this variability are unpredictable external factors such as inflation rates, changes in severity, benefit level changes, medical costs, and claims settlement patterns. This self-insurance liability is included in accrued liabilities and represents management's best estimate of the amounts that have been incurred but not yet been paid as of November 27, 2016 and May 29, 2016. It is reasonably possible that the expense the Company ultimately incurs could differ from these estimates and adjustments to future reserves may be necessary.

## **Fair Value Measurements**

The Company uses fair value measurement accounting for financial assets and liabilities and for financial instruments and certain other items measured at fair value. The Company has elected the fair value option for its investment in a non-public company (see Note 2). The Company has not elected the fair value option for any of its other eligible financial assets or liabilities.

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

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

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

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

As of November 27, 2016 and May 29, 2016, the Company held certain assets that are required to be measured at fair value on a recurring basis, including its interest rate swap and its minority interest investment in Windset.

The fair value of the Company's interest rate swap is determined based on model inputs that can be observed in a liquid market, including yield curves, and is categorized as a Level 2 measurement and is recorded as other assets in the Consolidated Balance Sheet.

The Company has elected the fair value option of accounting for its investment in Windset. The calculation of fair value utilizes significant unobservable inputs, including projected cash flows, growth rates, and discount rates. As a result, the Company's investment in Windset is considered to be a Level 3 measurement investment. The fair value of the Company's investment in Windset did not change for the six months ended November 27, 2016. In determining the fair value of the investment in Windset, the Company utilizes the following significant unobservable inputs in the discounted cash flow models:

November 27, 2016

May 29, 2016

Revenue growth rates

4% 4%

Expense growth rates

4% 4%



Income tax rates

15% 15%

Discount rates

12% 12.5%

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The revenue growth, expense growth, and income tax rate assumptions are considered the Company's best estimate of the trends in those items over the discount period. The discount rate assumption takes into account the risk-free rate of return, the market equity risk premium, and the company's specific risk premium and then applies an additional discount for lack of liquidity of the underlying securities. The discounted cash flow valuation model used by the Company has the following sensitivity to changes in inputs and assumptions (in thousands):

Impact on value of

investment in Windset

as of November 27, 2016

10% increase in revenue growth rates

\$ 400

10% increase in expense growth rates

\$ (400

)

10% increase in income tax rates

\$ —

10% increase in discount rates

\$ (200

)

Imprecision in estimating unobservable market inputs can affect the amount of gain or loss recorded for a particular position. The use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table summarizes the fair value of the Company's assets and liabilities that are measured at fair value on a recurring basis (in thousands):

Fair Value at November 27, 2016

Fair Value at May 29, 2016

Level 1

Level 2

Level 3

Level 1

Level 2

Level 3

Assets:

Interest rate swap (1)

\$ — \$ 519 \$ — \$ — \$ — \$ —

Investment in non-public company

— — 62,700 — — 62,700

Total

\$ — \$ 519 \$ 62,700 \$ — \$ — \$ 62,700

(1)

Recorded in Other assets.

### **Revenue Recognition**

See Note 11 – Business Segment Reporting, for a discussion about the Company’s four business segments; namely, Packaged Fresh Vegetables, Food Export, Biomaterials, and Corporate.

Revenue from product sales is recognized when there is persuasive evidence that an arrangement exists, title has transferred, the price is fixed and determinable, and collectability is reasonably assured. Allowances are established for estimated uncollectible amounts, product returns, and discounts based on specific identification and historical losses.

Apio’s Packaged Fresh Vegetables revenues generally consist of revenues generated from the sale of specialty packaged fresh-cut and whole value-added vegetable products that are generally washed and packaged in Apio’s proprietary packaging and sold under Apio’s Eat Smart and GreenLine brands and various private labels. Revenue is generally recognized upon shipment of these products to customers. The Company takes title to all produce it trades and/or packages, and therefore, records revenues and cost of sales at gross amounts in the Consolidated Statements of Comprehensive Income.

In addition, Packaged Fresh Vegetables 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, and from the sale of BreatheWay® packaging to license partners. Revenue is recognized on the vegetable cooling operations as cooling and storage services are provided to Apio’s customers. Sales of BreatheWay packaging are recognized when shipped to Apio’s customers.

Apio’s Food Export revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products to Asia through its subsidiary, Cal-Ex Trading Company (“Cal-Ex”). As most Cal-Ex customers are in countries outside of the U.S., title transfers and revenue is generally recognized upon arrival of the shipment in the foreign port. Apio records revenue equal to the sale price to third parties because it takes title to the product while in transit.

Lifecore's Biomaterials business principally generates revenue through the sale of products containing HA. Lifecore primarily sells products to customers in three medical areas: (1) Ophthalmic, which represented approximately 55% of Lifecore's revenues in fiscal year 2016, (2) Orthopedic, which represented approximately 20% of Lifecore's revenues in fiscal year 2016, and (3) Other/Non-HA products, which represented approximately 25% of Lifecore's revenues in fiscal year 2016. The vast majority of Lifecore's revenues are recognized upon shipment.

Lifecore's business development revenues, a portion of which are included in all three medical areas, are related to contract research and development ("R&D") services and multiple element arrangement services with customers where the Company provides products and/or services in a bundled arrangement.

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

For sales arrangements that contain multiple elements, the Company splits the arrangement into separate units of accounting if the individually delivered elements have value to the customer on a standalone basis. The Company also evaluates whether multiple transactions with the same customer or related party should be considered part of a multiple element arrangement, whereby the Company assesses, among other factors, whether the contracts or agreements are negotiated or executed within a short time frame of each other or if there are indicators that the contracts are negotiated in contemplation of each other. The Company then allocates revenue to each element based on a selling price hierarchy. The relative selling price for a deliverable is based on its vendor-specific objective evidence ("VSOE"), if available, third-party evidence ("TPE"), if VSOE is not available, or estimated selling price, if neither VSOE nor TPE is available. The Company then recognizes revenue on each deliverable in accordance with its policies for product and service revenue recognition. The Company is not typically able to determine VSOE or TPE, and therefore, uses the estimated selling price to allocate revenue between the elements of an arrangement.

The Company limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services or future performance obligations or subject to customer-specific cancellation rights. The Company evaluates each deliverable in an arrangement to determine whether it represents a separate unit of accounting. A deliverable constitutes a separate unit of accounting when it has stand-alone value, and for an arrangement that includes a general right of return relative to the delivered products or services, delivery or performance of the undelivered product or service is considered probable and is substantially controlled by the Company. The Company considers a deliverable to have stand-alone value if the product or service is sold separately by the Company or another vendor or could be resold by the customer. Further, the revenue arrangements generally do not include a general right of return relative to delivered products. Where the aforementioned criteria for a separate unit of accounting are not met, the deliverable is combined with the undelivered element(s) and treated as a single unit of accounting for the purposes of allocation of the arrangement consideration and revenue recognition. The Company allocates the total arrangement consideration to each separable element of an arrangement based upon the relative selling price of each element. Allocation of the consideration is determined at arrangement inception on the basis of each unit's relative selling price. In instances where the Company has not established fair value for any undelivered element, revenue for all elements is deferred until delivery of the final element is completed and all recognition criteria are met.

For licensing revenue, the initial license fees are deferred and amortized to revenue over the period of the agreement when a contract exists, the fee is fixed and determinable, and collectability is reasonably assured. Noncancellable, nonrefundable license fees are recognized over the period of the agreement, including those governing research and

development activities and any related supply agreement entered into concurrently with the license when the risk associated with commercialization of a product is non-substantive at the outset of the arrangement.

From time to time, the Company offers customers sales incentives, which include volume rebates and discounts. These amounts are estimated on a quarterly basis and recorded as a reduction of revenue.

A summary of revenues by type of arrangement as described above is as follows (in thousands):

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

November 27, 2016

November 29, 2015

Recorded upon shipment

\$

107,987

\$

112,709

\$

214,152

\$

223,125

Recorded upon acceptance in foreign port

25,701

22,140



49,040

44,484

Revenue from multiple element arrangements

1,683

4,058

3,268

5,647

Revenue from license fees, R&D contracts and royalties/profit sharing

494

1,534

1,799

2,540

Total

\$

135,865

\$

140,441

\$

268,259

\$

275,796

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## **Legal Contingencies**

In the ordinary course of business, the Company is involved in various legal proceedings and claims related to matters such as wage and hour claims.

The Company makes a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least each fiscal quarter and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel, and other information and events pertaining to a particular matter. In management's opinion, resolution of all current matters is not expected to have a material adverse impact on the Company's consolidated financial statements. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company's results of operations or cash flows, or both, in a particular quarter.

During the six months ended November 27, 2016, the Company recorded a charge to income in the amount of \$500,000, or \$0.01 per diluted share after taxes, which combined with amounts previously accrued is the Company's best estimate of settlement charges for all legal matters currently underway.

## **Recently Adopted Accounting Guidance**

### *Debt Extinguishment Costs*

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-15, *Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments* ("ASU 2016-15"). ASU 2016-15 clarifies how entities should classify certain cash receipts and cash payments in the statement of cash flows and amends certain disclosure requirements of ASC 230. ASU 2016-15 is intended to reduce diversity in practice with respect to eight types of cash flows including debt prepayment or debt extinguishment costs; proceeds from settlement of insurance claims; classification of cash receipts and payments that have aspects of more than one class of cash; and contingent consideration payments made after a business combination. The guidance is effective for fiscal years beginning after 15 December 2017, and interim periods within those years. Early adoption is permitted, including adoption in an interim period. The Company elected to early adopt ASU 2016-15 effective November 27, 2016. The adoption had no impact on our consolidated financial statements or related disclosures. The Company paid \$233,000 of early debt extinguishment penalties during the fiscal quarter ended November 27, 2016.

### *Debt Issuance Costs*

In April 2015, the FASB issued ASU 2015-03, *Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs* (“ASU 2015-03”). The new guidance requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, rather than as an asset, except in instances where proceeds from the related debt agreement have not been received.

In August 2015, the FASB issued ASU 2015-15, *Presentation and Subsequent Measurement of Debt Issuance Costs Associated With Line-of-Credit Arrangements* (“ASU 2015-15”). ASU 2015-15 amends Subtopic 835-30 to clarify that the Securities and Exchange Commission would not object to the deferral and presentation of debt issuance costs as an asset and subsequent amortization of the deferred costs ratably over the term of the line of credit arrangement, regardless of whether there are any outstanding borrowings on the arrangement.

The Company adopted ASU 2015-03 and ASU 2015-15 during its first fiscal quarter ended August 28, 2016 with retrospective application to its May 29, 2016 consolidated balance sheet. The effect of the adoption of ASU 2015-03 was to reclassify total debt issuance costs of \$817,000 as of May 29, 2016 as a deduction from the related debt liabilities. Accordingly, the May 29, 2016 consolidated balance sheet was adjusted as follows: (1) prepaid expenses and other current assets and total current assets were reduced by \$175,000 and current portion of long-term debt and total current liabilities were reduced by the same; (2) other assets were reduced by \$642,000 and long-term debt was reduced by the same; and (3) total assets were reduced by \$817,000 and total liabilities were reduced by the same. There was no effect related to the adoption of ASU 2015-15 given the Company has historically presented line of credit debt issuance costs as an asset, and as such, \$120,00 and \$459,000 remain as prepaid expenses and other current assets and other assets, respectively, as of November 27, 2016. ASU 2015-03 and ASU 2015-15 do not impact the income statement accounting for debt issuance costs; therefore, these costs will continue to be amortized to interest expense over the term of the related debt instruments. There was no effect on net income.

### *Stock-Based Compensation*

In March 2016, the FASB issued ASU 2016-09, *Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”). The new guidance changes the accounting for certain aspects of stock-based payments to employees and requires excess tax benefits and tax deficiencies to be recorded in the income statement when the awards vest or are settled. In addition, cash flows related to excess tax benefits will no longer be separately classified as a financing activity apart from other income tax cash flows. The standard also clarifies that all cash payments made on an employee’s behalf for withheld shares should be presented as a financing activity in the Company’s consolidated statements of cash flows and provides an accounting policy election to account for forfeitures as they occur. Finally, the new guidance eliminates the requirement to delay the recognition of excess tax benefits until it reduces current taxes payable. The new standard is effective for the Company beginning May 29, 2017, with early adoption permitted.

The Company elected to early adopt the new guidance in for the quarter beginning May 30, 2016. Accordingly, the primary effects of the adoption are as follows: (1) using a modified retrospective application, the Company recorded unrecognized excess tax benefits of \$549,000 as a cumulative-effect adjustment, which increased retained earnings, and reduced deferred taxes by the same, (2) using a modified retrospective application, the Company has elected to recognize forfeitures as they occur and recorded a \$200,000 increase to additional paid-in capital, a \$126,000 reduction to retained earnings, and a \$74,000 reduction to deferred taxes to reflect the incremental stock-based compensation expense, net of the related tax impacts, that would have been recognized in prior years under the modified guidance, and (3) \$90,000 in excess tax benefits from stock-based compensation was reclassified from cash flows from financing activities to cash flows from operating activities for the six months ended November 29, 2015 in the consolidated statement of cash flows. See Note 5 – Income Taxes for further information regarding additional effects related to the prospective application of excess tax benefits and tax deficiencies related to stock-based compensation on the Company’s financial statements.

### **Recent Accounting Guidance Not Yet Adopted**

#### *Leases*

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* (“ASU 2016-02”), which requires companies to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use-assets. ASU 2016-02 also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases. The new guidance is effective for the Company beginning in the first quarter of fiscal year 2020 on a modified retrospective basis, with early adoption permitted. Management is currently evaluating the timing of its adoption and the effect ASU 2016-02 will have on the Company's Consolidated Financial Statements and disclosures.

*Revenue Recognition*

In May 2014, the FASB issued ASU 2014-09, which creates FASB ASC Topic 606, *Revenue from Contracts with Customers* and supersedes ASC Topic 605, *Revenue Recognition* (“ASU 2014-09”). The guidance replaces industry-specific guidance and establishes a single five-step model to identify and recognize revenue. The core principle of the guidance is that an entity should recognize revenue upon transfer of control of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. Additionally, the guidance requires the entity to disclose further quantitative and qualitative information regarding the nature and amount of revenues arising from contracts with customers, as well as other information about the significant judgments and estimates used in recognizing revenues from contracts with customers. The effective date of ASU 2014-09 was deferred by the issuance of ASU 2015-14, *Revenue from Contracts with Customers: Deferral of the Effective Date, (Topic 606)* by one year to make the guidance of ASU 2014-09 effective for annual reporting periods beginning after December 15, 2017, including interim periods therein. Early adoption is permitted, but not prior to the original effective date, which was for annual reporting periods beginning after December 15, 2016. In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606) Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, which clarifies how to apply the implementation guidance on principal versus agent considerations related to the sale of goods or services to a customer as updated by ASU 2014-09. In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606) Identifying Performance Obligations and Licensing*, which clarifies two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance, while retaining the related principles for those areas, as updated by ASU 2014-09. In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, which makes narrow scope amendments to Topic 606 including implementation issues on collectability, non-cash consideration and completed contracts at transition. The Company is currently assessing the future impact of this guidance on its consolidated financial statements and related disclosures and expects to adopt these updates beginning with the first quarter of its fiscal year 2019.

2.

### **Investment in Non-public Company**

On February 15, 2011, Apio entered into a share purchase agreement (the “Windset Purchase Agreement”) with Windset. Pursuant to the Windset Purchase Agreement, Apio purchased from Windset 150,000 Senior A preferred shares for \$15 million and 201 common shares for \$201. On July 15, 2014, Apio increased its investment in Windset by purchasing from the Newell Capital Corporation an additional 68 shares of common stock and 51,211 shares of junior preferred stock of Windset for \$11 million. After this purchase, the Company’s common shares represent a 26.9% ownership interest in Windset. The non-voting Senior A preferred shares yield a cash dividend of 7.5% annually. The dividend is payable within 90 days of each anniversary of the execution of the Windset Purchase Agreement. The non-voting junior preferred stock does not yield a dividend unless declared by the Board of Directors of Windset and no such dividend has been declared.

The Windset Purchase Agreement includes a put and call option, which can be exercised on the sixth anniversary of the Windset Purchase Agreement whereby Apio can exercise the put to sell its common, Senior A preferred shares, and junior preferred shares to Windset, or Windset can exercise the call to purchase those shares from Apio, in either case, at a price equal to 26.9% of the fair market value of Windset’s common shares, plus the liquidation value of the preferred shares of \$20.1 million (\$15 million for the Senior A preferred shares and \$5.1 million for the junior preferred shares). Under the terms of the arrangement with Windset, the Company is entitled to designate one of five members on the Board of Directors of Windset.

On October 29, 2014, Apio further increased its investment in Windset by purchasing 70,000 shares of Senior B preferred shares for \$7 million. The Senior B Preferred Stock pays an annual dividend of 7.5% on the amount outstanding at each anniversary date of the Windset Purchase Agreement. The Senior B shares purchased by Apio have a put feature whereby Apio can sell back to Windset \$1.5 million of shares on the first anniversary, an additional \$2.75 million of shares on the second anniversary, and the remaining \$2.75 million on the third anniversary. After the third anniversary, Apio may at any time put any or all of the shares not previously sold back to Windset. At any time on or after February 15, 2017, Windset has the right to call any or all of the outstanding common shares, but at such time must also call the same proportion of Senior A preferred shares, Senior B preferred shares, and junior preferred shares owned by Apio. Windset’s partial call provision is restricted such that a partial call cannot result in Apio holding less than 10% of Windset’s common shares outstanding.

The investment in Windset does not qualify for equity method accounting as the investment does not meet the criteria of in-substance common stock due to returns through the annual dividend on the non-voting senior preferred shares that are not available to the common stock holders. As the put and call options require all of the various shares to be put or called in equal proportions, the Company has deemed that the investment, in substance, should be treated as a single security for purposes of accounting.



The fair value of the Company's investment in Windset was determined utilizing the Windset Purchase Agreement's put/call calculation for value and a discounted cash flow model based on projections developed by Windset, and considers the put and call conversion options. These features impact the duration of the cash flows utilized to derive the estimated fair values of the investment. These two discounted cash flow models' estimate for fair value are then weighted. Assumptions included in these discounted cash flow models will be evaluated quarterly based on Windset's actual and projected operating results to determine the change in fair value.

During each of the three months ended November 27, 2016 and November 29, 2015, the Company recorded \$412,500 in dividend income. During each of the six months ended November 27, 2016 and November 29, 2015, the Company recorded \$825,000 in dividend income. The increase in the fair market value of the Company's investment in Windset for the three months ended November 27, 2016 and November 29, 2015 was \$0 and \$200,000, respectively, and is included in other income in the Consolidated Statements of Comprehensive Income. The increase in the fair market value of the Company's investment in Windset for the six months ended November 27, 2016 and November 29, 2015 was \$0 and \$1.0 million, respectively, and is included in other income in the Consolidated Statements of Comprehensive Income.

### 3.

#### **Stock-Based Compensation**

The Company's stock-based awards include stock option grants and restricted stock unit awards ("RSUs"). The Company records compensation expense for stock-based awards issued to employees and directors in exchange for services provided based on the estimated fair value of the awards on their grant dates and is recognized over the required service periods, generally the vesting period.

The following table summarizes the stock-based compensation for options and RSUs (in thousands):

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

November 27, 2016

November 29, 2015

Options

\$ 307	\$ 360	\$ 599	\$ 690
--------	--------	--------	--------

RSUs

659	540	1,174	1,007
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Total stock-based compensation

\$ 966	\$ 900	\$ 1,773	\$ 1,697
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The following table summarizes the stock-based compensation by income statement line item (in thousands):

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

November 27, 2016

November 29, 2015

Cost of sales

\$ 124   \$ 100   \$ 237   \$ 198

Research and development

23   23   46   45

Selling, general and administrative

819   777   1,490   1,454

Total stock-based compensation

\$ 966   \$ 900   \$ 1,773   \$ 1,697

The estimated fair value for stock options, which determines the Company's calculation of stock-based compensation expense, is based on the Black-Scholes option pricing model. RSUs are valued at the closing market price of the Company's common stock on the date of grant. The Company uses the straight-line single option method to calculate and recognize the fair value of stock-based compensation arrangements.

As of November 27, 2016, there was \$6.5 million of total unrecognized compensation expense related to unvested equity compensation awards granted under the Landec incentive stock plans. Total expense is expected to be recognized over the weighted-average period of 1.8 years for stock options and 1.7 years for restricted stock unit awards.

**4.**

**Diluted Net Income Per Share**

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

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

November 27, 2016

November 29, 2015

Numerator:

Net income applicable to Common Stockholders

\$ 1,326   \$ 1,868   \$ 4,638   \$ 4,820

Denominator:

Weighted average shares for basic net income per share

27,249	27,021	27,234	27,013
--------	--------	--------	--------

Effect of dilutive securities:

Stock options and restricted stock units

369	399	338	404
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Weighted average shares for diluted net income per share

27,618	27,420	27,572	27,417
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Diluted net income per share

\$ 0.05	\$ 0.07	\$ 0.17	\$ 0.18
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For the three months ended November 27, 2016 and November 29, 2015, the computation of the diluted net income per share excludes the impact of options to purchase 1,266,040 shares and 1,140,789 shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

For the six months ended November 27, 2016 and November 27, 2015, the computation of the diluted net income per share excludes the impact of options to purchase 1,415,024 shares and 1,119,543 shares of Common Stock, respectively, as such impacts would be antidilutive for these periods.

5.

## Income Taxes

The provision for income taxes for the three months ended November 27, 2016 and November 29, 2015 was \$693,000 and \$1.1 million, respectively. The provision for income taxes for the six months ended November 27, 2016 and November 29, 2015 was \$2.6 million and \$2.8 million, respectively. The effective tax rate for the three months ended November 27, 2016 was 34%. The effective tax rate for the three months ended November 27, 2016 was lower than the statutory federal income tax rate of 35% primarily due to the domestic manufacturing deduction and research and development credits; partially offset by state taxes and non-deductible stock-based compensation expense. The effective tax rate for the six months ended November 27, 2016 and the three and six months ended November 29, 2015 was 36%. The effective tax rate for the six months ended November 27, 2016 and the three and six months ended November 29, 2015 was higher than the statutory federal income tax rate of 35% primarily due to state taxes and non-deductible stock-based compensation expense; partially offset by the domestic manufacturing deduction and research and development credits.

As of November 27, 2016 and May 29, 2016, the Company had unrecognized tax benefits of approximately \$904,000 and \$842,000, respectively. Included in the balance of unrecognized tax benefits as of November 27, 2016 and May 29, 2016 is approximately \$764,000 and \$715,000, respectively, of tax benefits that, if recognized, would result in an adjustment to the Company's effective tax rate. In the twelve months following November 27, 2016, it is reasonably possible that approximately \$300,000 of other unrecognized tax benefits may be recognized.

During the six months ended November 27, 2016, excess tax deficiencies related to stock-based compensation of \$59,000 were reflected in the consolidated statements of comprehensive income as a component of income tax expense as a result of the early adoption of ASU 2016-09, specifically related to the prospective application of excess tax benefits and tax deficiencies related to stock-based compensation. See Note 1— Organization, Basis of Presentation, and Summary of Significant Accounting Policies for further discussion regarding the adoption of ASU 2016-09.

The Company has elected to classify interest and penalties related to uncertain tax positions as a component of its provision for income taxes. The Company has accrued an insignificant amount of interest and penalties relating to the income tax on the unrecognized tax benefits as of November 27, 2016 and May 29, 2016.

Due to tax attribute carryforwards, the Company is subject to examination for tax years 1997 forward for U.S. tax purposes. The Company is also subject to examination in various state jurisdictions for tax years 1998 forward, none of which were individually material.

6.

**Inventories**

Inventories are stated at the lower of cost (first-in, first-out method) or net realizable value and consists of the following (in thousands):

November 27, 2016

May 29, 2016

Finished goods

\$ 10,736    \$ 12,165

Raw materials

4,190    9,855

Work in progress

13,044    3,515

Total

\$ 27,970    \$ 25,535

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7.

**Debt**

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

November 27, 2016

May 29, 2016

Term loan with JPMorgan Chase Bank (“JPMorgan”), BMO Harris Bank N.A. (“BMO”), and City National Bank; due in quarterly principal and interest payments of \$1,250 beginning December 1, 2016 through September 23, 2021 with the remainder due on maturity, with interest based on the Company’s leverage ratio at a per annum rate of the Eurodollar rate plus a spread of between 1.25% and 2.25%

\$ 50,000    \$ —

Real property loan agreement with General Electric Capital Corporation (“GE Capital”); due in monthly principal and interest payments of \$133 through May 1, 2022 with interest based on a fixed rate of 4.02% per annum

—    14,167

Capital equipment loan with GE Capital; due in monthly principal and interest payments of \$175 through May 1, 2019 with interest based on a fixed rate of 4.39% per annum

—    5,904

Capital equipment loan with GE Capital; due in monthly principal and interest payments of \$95 through July 17, 2019 with interest based on a fixed rate of 3.68% per annum

—    5,558

Capital equipment loan with GE Capital; due in monthly principal and interest payments of \$56 through December 1, 2019 with interest based on a fixed rate of 3.74% per annum

—    3,375



Capital equipment loan with Bank of America (“BofA”); due in monthly principal and interest payments of \$68 through June 28, 2020 with interest based on a fixed rate of 2.79% per annum

— 3,158

Real property loan agreement with GE Capital; due in monthly principal payments of \$32 through March 1, 2026, plus interest payable monthly at LIBOR plus 2.25% per annum

— 7,622

Capital equipment loan with GE Capital; due in monthly principal payments of \$108 through March 1, 2021, plus interest payable monthly at LIBOR plus 2.25% per annum

— 8,873

Capital equipment loan with BofA; due in monthly principal and interest payments of \$75 through November 27, 2020 with interest based on a fixed rate of 2.92% per annum

— 3,940

Industrial revenue bonds (“IRBs”) issued by Lifecore; due in annual payments through 2020 with interest at a variable rate set weekly by the bond remarketing agent (0.59% at May 29, 2016)

— 2,065

Total principal amount of long-term debt

50,000 54,662

Less: unamortized debt issuance costs

(289

)

(817

)

Total long-term debt, net of unamortized debt issuance costs

49,711 53,845

Less: current portion of long-term debt, net

(4,940

)

(7,873

)

Long-term debt, net

\$ 44,771    \$ 45,972

On September 23, 2016, the Company entered into a Credit Agreement with JPMorgan, BMO, and City National Bank, as lenders (collectively, the “Lenders”), and JPMorgan as administrative agent, pursuant to which the Lenders provided the Company with a \$100 million revolving line of credit (the “Revolver”) and a \$50 million term loan facility (the “Term Loan”), guaranteed by each of the Company’s direct and indirect subsidiaries and secured by substantially all of the Company’s assets, with the exception of the Company’s investment in Windset.

Both the Revolver and the Term Loan mature in five years (on September 23, 2021), with the Term Loan providing for quarterly principal payments of \$1.25 million commencing December 1, 2016, with the remainder due at maturity.

Interest on both the Revolver and the Term Loan is based either the prime rate or Eurodollar rate, at the Company’s discretion, plus a spread based on the Company’s leverage ratio (generally defined as the ratio of the Company’s total indebtedness on such date to the Company’s consolidated earnings before interest, taxes, depreciation, and amortization (“EBITDA”) for the period of four consecutive fiscal quarters ended on or most recently prior to such date). The spread is at a per annum rate of (i) between 0.25% and 1.25% if the prime rate is elected or (ii) between 1.25% and 2.25% if the Eurodollar rate is elected.

The Credit Agreement also contains an accordion feature that provides the Company the right to increase the Revolver commitments and/or the Term Loan commitments by obtaining additional commitments either from one or more of the Lenders or another lending institution at an amount of up to \$75 million.

The Credit Agreement contains customary financial covenants and events of default under which the obligation could be accelerated and/or the interest rate increased. The Company was in compliance with all financial covenants as of November 27, 2016.

On November 1, 2016, the Company entered into an interest rate swap agreement (“Swap”) with BMO at a notional amount of \$50 million. The Swap has the effect of changing the Company’s Term Loan obligation from a variable interest rate to a fixed 30-day LIBOR rate of 1.22%. As of November 27, 2016, the interest rate on the Term Loan was 2.97%. For further discussion regarding the Company’s use of derivative instruments, see the Financial Instruments section of Note 1 – Organization, Basis of Presentation, and Summary of Significant Accounting Policies.

In connection with the Credit Agreement, the Company incurred lender and third-party debt issuance costs of \$897,000, of which \$598,000 and \$299,000 was allocated to the Revolver and Term Loan, respectively.

As of November 27, 2016, \$1.5 million was outstanding on the Revolver. As of November 27, 2016, the interest rate on the Revolver was 2.29%.

Concurrent with the close of the Credit Agreement, all of the proceeds of the Term Loan, and \$1.5 million of the Revolver, was used by the Company to repay all then existing debt. Accordingly, the Company recognized a loss on debt refinancing of \$1.2 million, including \$233,000 of payments for early debt extinguishment penalties, for the quarter ended November 27, 2016, primarily related to the write-off of unamortized debt issuance costs on the Company’s then existing debt as of September 23, 2016.

## **8.**

### **Related Party**

The Company sells products to and earns license fees from Windset. During the three months ended November 27, 2016 and November 29, 2015, the Company recognized revenues of \$75,000 and \$140,000, respectively. During the six months ended November 27, 2016 and November 29, 2015, the Company recognized revenues of \$193,000 and \$266,000, respectively. These amounts have been included in product sales in the accompanying Consolidated Statements of Comprehensive Income. The associated receivable balances of \$183,000 and \$523,000 are included in accounts receivable in the accompanying Consolidated Balance Sheets as of November 27, 2016 and May 29, 2016, respectively.

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

9.

### **Stockholders' Equity**

During the three months ended November 27, 2016, the Company did not grant any options to purchase common stock and awarded 100,522 restricted stock units. During the six months ended November 27, 2016, the Company granted options to purchase 180,000 shares of common stock and awarded 110,522 restricted stock units.

As of November 27, 2016, the Company has reserved 2.6 million shares of Common Stock for future issuance under its current and former equity plans.

On July 14, 2010, the Company announced that the Board of Directors of the Company had approved the establishment of a stock repurchase plan authorizing the repurchase of up to \$10 million of the Company's Common Stock. The Company may repurchase its common stock from time to time in open market purchases or in privately negotiated transactions. The timing and actual number of shares repurchased is at the discretion of management of the Company and will depend on a variety of factors, including stock price, corporate and regulatory requirements, market conditions, the relative attractiveness of other capital deployment opportunities and other corporate priorities. The stock repurchase program does not obligate Landec to acquire any amount of its common stock and the program may be modified, suspended or terminated at any time at the Company's discretion without prior notice. During the three and six months ended November 27, 2016, the Company did not purchase any shares on the open market.

**10.****Comprehensive Income**

Comprehensive income consists of two components, net income and Other Comprehensive Income (“OCI”). OCI refers to revenue, expenses, and gains and losses that under GAAP are recorded as a component of stockholders’ equity but are excluded from net income. The Company’s OCI consists of net deferred gains and losses on its interest rate swap derivative instrument accounted for a cash flow hedge. The components of OCI, net of tax, were as follows (in thousands):

Unrealized Gains on

Cash Flow Hedge

Balance as of August 28, 2016

\$ -

Other comprehensive income before reclassifications, net of tax effect

327

Amounts reclassified from OCI

(-

)

Other comprehensive income, net

327

Balance as of November 27, 2016

\$ 327

The Company does not expect any transactions or other events to occur that would result in the reclassification of any significant gains into earnings in the next 12 months.

11.

### **Business Segment Reporting**

The Company manages its business operations through three strategic business units. Based upon the information reported to the chief operating decision maker, who is the Chief Executive Officer, the Company has the following reportable segments: the Packaged Fresh Vegetables segment, the Food Export segment, and the Biomaterials segment.

The Packaged Fresh Vegetables segment markets and packs specialty packaged whole and fresh-cut vegetables, the majority of which incorporate the BreatheWay specialty packaging for the retail grocery, club store, and food services industries. In addition, the Packaged Fresh Vegetables segment sells BreatheWay packaging to partners for fruit and vegetable products. The Food Export segment consists of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products primarily to Asia. The Biomaterials segment sells products utilizing hyaluronan, a naturally occurring polysaccharide that is widely distributed in the extracellular matrix of connective tissues in both animals and humans, and non-HA products for medical use primarily in the Ophthalmic, Orthopedic, and other markets. Corporate licenses Landec's Intelimer polymers for agricultural products, personal care products, and other industrial products. The Corporate segment also includes general and administrative expenses, non-Packaged Fresh Vegetables and non-Biomaterials interest income and income tax expenses. All of the assets of the Company are located within the United States of America. The Company's international sales were as follows (in millions):

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

November 27, 2016

November 29, 2015

## Canada

\$ 16.3	\$ 20.0	\$ 34.0	\$ 40.4
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## Taiwan

\$ 11.1	\$ 12.4	\$ 24.9	\$ 25.4
---------	---------	---------	---------

## China

\$ 6.3	\$ 3.3	\$ 11.4	\$ 7.3
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## Indonesia

\$ 3.6	\$ 2.5	\$ 5.1	\$ 3.9
--------	--------	--------	--------

## Japan

\$ 2.9	\$ 1.6	\$ 4.9	\$ 3.6
--------	--------	--------	--------

## Belgium

\$ 1.6	\$ 0.2	\$ 6.9	\$ 1.0
--------	--------	--------	--------

## Philippines

\$ 0.7	\$ 0.6	\$ 1.3	\$ 1.5
--------	--------	--------	--------

## All Other Countries

\$ 3.5	\$ 3.4	\$ 5.7	\$ 7.1
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Operations by business segment consisted of the following (in thousands):

Three Months Ended November 27, 2016

Packaged Fresh Vegetables

Food Export

Biomaterials

Corporate

Total

Net sales

\$ 97,978   \$ 25,701   \$ 11,931   \$ 255   \$ 135,865

International sales

\$ 16,422   \$ 25,701   \$ 3,831   \$ —   \$ 45,954

Gross profit

\$ 12,001   \$ 1,850   \$ 4,938   \$ 164   \$ 18,953

Net income (loss)

\$ (250 )   \$ 733   \$ 1,312   \$ (469

)

\$ 1,326



Depreciation and amortization

\$ 1,792 \$ 2 \$ 719 \$ 37 \$ 2,560

Dividend income

\$ 413 \$ — \$ — \$ — \$ 413

Interest income

\$ 3 \$ — \$ — \$ — \$ 3

Interest expense

\$ 122

\$ — \$ (90 ) \$ 348

\$ 380

Income tax expense (benefit)

\$ (142 ) \$ 207 \$ 388 \$ 240 \$ 693

Three Months Ended November 29, 2015

Net sales

\$ 107,164 \$ 22,140 \$ 10,249 \$ 888 \$ 140,441

International sales

\$ 19,800 \$ 22,140 \$ 2,032 \$ — \$ 43,972

Gross profit

\$ 9,979 \$ 1,676 \$ 4,881 \$ 729 \$ 17,265

Net income (loss)

\$ (658

)

\$ 1,176 \$ 1,393 \$ (43

)

\$ 1,868

Depreciation and amortization

\$ 1,448 \$ — \$ 641 \$ 39 \$ 2,128

Dividend income

\$ 413 \$ — \$ — \$ — \$ 413

Interest income

\$ 16 \$ — \$ — \$ — \$ 16

Interest expense

\$ 410 \$ — \$ 29 \$ — \$ 439

Income tax expense (benefit)

\$ (16

)

\$ 161 \$ 393 \$ 531 \$ 1,069

Six Months Ended November 27, 2016

Net sales

\$ 193,923 \$ 49,040 \$ 24,263 \$ 1,033 \$ 268,259

International sales

\$ 34,266 \$ 49,040 \$ 10,873 \$ — \$ 94,179

Gross profit

\$ 26,407 \$ 2,878 \$ 10,060 \$ 752 \$ 40,097

Net income (loss)

\$

2,073

\$

928 \$ 2,555 \$ (918

)

\$ 4,638

Depreciation and amortization

\$ 3,612 \$ 3 \$ 1,431 \$ 64 \$ 5,110

Dividend income

\$ 825 \$ — \$ — \$ — \$ 825

Interest income

\$ 7 \$ — \$ — \$ — \$ 7

Interest expense

\$ 671 \$ — \$ 13 \$ 348 \$ 1,032

Income tax expense

\$ 513 \$ 262 \$ 738 \$ 1,069 \$ 2,582

Six Months Ended November 29, 2015

Net sales

\$ 210,870 \$ 44,484 \$ 19,047 \$ 1,395 \$ 275,796

International sales

\$ 40,605 \$ 44,484 \$ 5,159 \$ — \$ 90,248

Gross profit

\$ 23,231 \$ 2,679 \$ 8,096 \$ 1,236 \$ 35,242

Net income (loss)

\$ 2,602 \$ 1,277 \$ 1,461 \$ (520

)

\$ 4,820

Depreciation and amortization

\$ 3,015    \$ 1    \$ 1,246    \$ 77    \$ 4,339

Dividend income

\$ 825    \$ —    \$ —    \$ —    \$ 825

Interest income

\$ 22    \$ —    \$ 25    \$ —    \$ 47

Interest expense

\$ 877    \$ —    \$ 64    \$ —    \$ 941

Income tax expense

\$ 905    \$ 189    \$ 412    \$ 1,254    \$ 2,760

During the six months ended November 27, 2016 and November 29, 2015, sales to the Company's top five customers accounted for 44% and 45%, respectively, of sales. The Company's top two customers, Costco Wholesale Corporation and Wal-Mart Stores, Inc., from the Packaged Fresh Vegetables segment accounted for 17% and 13% of revenues, respectively, for the six months ended November 27, 2016, and 19% and 11% respectively, for the six months ended November 29, 2015. The Company expects that, for the foreseeable future, a limited number of customers may continue to account for a significant portion of its net sales.

## **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 29, 2016.

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Potential risks and uncertainties include, without limitation, those mentioned in this Form 10-Q and those mentioned in Landec's Annual Report on Form 10-K for the fiscal year ended May 29, 2016. 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 29, 2016 filed with the Securities and Exchange Commission on July 29, 2016.

See Note 1 – Organization, Basis of Presentation, and Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements for a discussion of recently adopted accounting guidance and recent accounting guidance not yet adopted.

### **Derivative Instruments and Hedging**

The Company entered into an interest rate swap agreement to manage interest rate risk, and designated this derivative instrument as a cash flow hedge. See Note 1 – Organization, Basis of Presentation, and Summary of Significant Accounting Policies and Note 10 – Comprehensive Income of the Notes to Consolidated Financial Statements for further discussion.

## The Company

Landec Corporation and its subsidiaries (“Landec” or the “Company”) design, develop, manufacture, and sell differentiated health and wellness products for food and biomaterials markets. There continues to be a dramatic shift in consumer behavior to healthier eating habits and preventive wellness to improve quality of life. The Apio, Inc. (“Apio”) Packaged Fresh Vegetables business is committed to offering healthy, fresh produce products conveniently packaged to consumers. Apio also exports whole fruit and vegetables, predominantly to Asia through its subsidiary, Cal-Ex Trading Company (“Cal-Ex”). In the Lifecore Biomedical, Inc. (“Lifecore”) biomaterials business, we commercialize products that enable people to stay more active as they grow older.

Landec’s Packaged Fresh Vegetables and Biomaterials businesses utilize polymer chemistry technology, a key differentiating factor. Both businesses focus on business-to-business selling such as selling directly to retail grocery store chains and club stores for Apio, and directly to partners in the medical device and pharmaceutical markets, with a concentration in ophthalmology for Lifecore.

Within Landec’s two core businesses, there are three operating segments – Packaged Fresh Vegetables, Food Export, and Biomaterials, each of which is described below.

Apio operates the Packaged Fresh Vegetables business, which combines proprietary BreatheWay® food packaging technology with the capabilities of a large national food supplier and value-added produce processor which sells products under the Eat Smart brand to consumers and the GreenLine® brand to foodservice operators, as well as under private labels. In Apio’s Packaged Fresh Vegetables operations, produce is processed by trimming, washing, sorting, blending, and packaging into bags and trays that generally incorporates Landec’s BreatheWay membrane technology. The BreatheWay membrane increases shelf-life and reduces shrink (waste) for retailers and helps to ensure that consumers receive fresh produce by the time the product makes its way through the supply chain. Apio also generates revenue from the sale and/or use of its BreatheWay technology by partners such as Chiquita Brands International, Inc. (“Chiquita”) for packaging and distribution of bananas and berries and Windset Holdings 2010 Ltd., a Canadian corporation (“Windset”), for packaging of greenhouse grown cucumbers and peppers, and to Juicero, Inc. (“Juicero”) innovator of the first in-home cold-press fruit and vegetable juicing system. Juicero is using BreatheWay membranes to extend the shelf-life of fresh fruit and vegetables packets.

Apio also operates the Food Export business. The Food Export business purchases and sells whole fruit and vegetable commodities predominantly to Asian markets.

Lifecore operates the Biomaterials business and is principally involved in the development and manufacture of pharmaceutical-grade sodium hyaluronate (“HA”) products and aseptic contract manufacturing. Sodium hyaluronate is a naturally occurring polysaccharide that is widely distributed in the extracellular matrix in animals and humans. Based upon Lifecore’s expertise working with highly viscous HA, the Company specializes in fermentation and aseptic filling services, as a contract development and manufacturing organization, for difficult to handle (viscous) medicines filled in finished dose syringes.

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

## **Description of Core Business**

Landec operates its business in three core business segments: Packaged Fresh Vegetables, Food Export and Biomaterials.

### ***Packaged Fresh Vegetables Business***

Based in Guadalupe, California, Apio’s primary business is fresh-cut and whole vegetable products primarily packaged in proprietary BreatheWay packaging. The Packaged Fresh Vegetables business markets a variety of fresh-cut and whole vegetables to the top retail grocery chains, club stores, and food service operators. During the fiscal year ended May 29, 2016, Apio shipped approximately 30 million cartons of produce to its customers throughout North America, primarily in the United States.

There are four major distinguishing characteristics of Apio that provide competitive advantages in the Packaged Fresh Vegetables market:

(1)

**Packaged Vegetables Supplier:** Apio has structured its business as a marketer and seller of branded and private label blended, fresh-cut, and whole vegetable products. It is focused on selling products primarily under its Eat Smart brand, with some sales under its GreenLine brand, and private label brands. As retail grocery chains, club stores, and food service operators consolidate, Apio is well positioned as a single source of a broad range of products.

(2)

**Nationwide Processing and Distribution:** Apio has strategically invested in its Packaged Fresh Vegetables business. Apio's largest processing plant is in Guadalupe, CA, and is automated with state-of-the-art vegetable processing equipment in one of the lowest cost, growing regions in California, the Santa Maria Valley. With the acquisition of GreenLine in 2012, Apio added three East Coast processing facilities and five East Coast distribution facilities for nationwide delivery of all of its packaged vegetable products in order to meet the next-day delivery needs of customers.

(3)

**Expanded Product Line Using Technology and Unique Blends:** Apio, through the use of its BreatheWay packaging technology, is introducing new packaged vegetable products each year. These new product offerings range from various sizes of vegetable salads, fresh-cut bagged products, vegetable trays, whole produce, and snack packs. During the last twelve months, Apio has introduced six new unique products.



(4)

**Products Currently in Approximately 60% of U.S. Retail Grocery Stores:** Apio has products in approximately 60% of all U.S. retail grocery stores. This gives Apio the opportunity to sell new products to existing customers and to increase distribution of its approximately 120 unique products within those customers.

Most vegetable products packaged in Apio's BreatheWay packaging have an approximate 17 day shelf-life. In addition to packaging innovation, Apio has developed innovative blends and combinations of vegetables that are sold in flexible film bags or rigid trays. More recently, Apio has launched a family of salad kits that are comprised of "superfood" mixtures of vegetables with healthy toppings and dressings. The first salad kit to launch under the Eat Smart® brand was Sweet Kale Salad, which now has significant distribution throughout club and retail stores in North America. Additionally, we have launched under the Eat Smart brand several other superfood salad kits including Ginger Bok Choy, Wild Greens and Quinoa, Beets and Greens, Southwest Salad, and Asian Sesame. The Company's expertise includes accessing leading culinary experts and nutritionists nationally to help in the new product development process. We believe that the Company's new products are "on trend" and strong market acceptance supports this belief. Recent statistics show that more than two-thirds of adults are considered to be overweight or obese and more than one-third of adults are considered to be obese. More and more consumers are beginning to make better food choices in their schools, homes, and in restaurants and that is where the superfood products can fit into consumers' daily healthy food choices.

In addition to proprietary packaging technology and a strong new product development pipeline, the Company has strong channels of distribution throughout North America with retail grocery store chains and club stores. Landec has one or more of its products in approximately 60% of all retail and club store sites in the U.S. giving it a strong platform for introducing new products.

The Company sells its products under its nationally-known brand Eat Smart to retail and club stores and its GreenLine brand to foodservice operators. The Company also periodically licenses its BreatheWay packaging technology to partners such as Chiquita for packaging bananas and berries, and Windset for packaging peppers and cucumbers that are grown hydroponically in greenhouses. The Company also licenses its BreatheWay technology to Juicero to extend the shelf-life of fresh produce packets for use in a countertop juicing system. These packaging license relationships generate revenues either from product sales or royalties once commercialized. The Company is engaged in the testing and development of other BreatheWay products. Landec manufactures its BreatheWay packaging through selected qualified contract manufacturers.

*Windset*

The Company believes that hydroponically-grown produce using Windset's know-how and growing practices will result in higher yields with competitive growing costs that will provide dependable year-round supply to Windset's customers. In addition, the produce grown in Windset's greenhouses uses significantly less water than field grown crops and has a very high safety profile as no soil is used in the growing process. Windset owns and operates greenhouses in British Columbia, Canada and in Nevada and California. In addition to growing produce in its own greenhouses, Windset has numerous marketing arrangements with other greenhouse growers and utilizes buy/sell arrangements to meet fluctuation in demand from their customers.

See Note 2 – Investment in Non-public Company of the Notes to Consolidated Financial Statements for a discussion about the Company's 26.9% minority ownership interest in Windset.

### ***Food Export Business***

Food Export revenues consist of revenues generated from the purchase and sale of primarily whole commodity fruit and vegetable products primarily to Asia through Apio's export company, Cal-Ex. The Food Export business is a buy/sell business that realizes a margin on average in the 5-10% range.

### ***Biomaterials Business***

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

(1)

**Establish strategic relationships with market leaders:** Lifecore will continue to develop applications for products with partners who have strong marketing, sales, and distribution capabilities to end-user markets. Through its strong reputation and history of providing pharmaceutical grade HA and products, Lifecore has been able to establish long-term relationships with the market leading ophthalmic surgical companies, and leverages those partnerships to attract new relationships in other medical markets.

(2)

**Expand medical applications for HA:** Due to the growing knowledge of the unique characteristics of HA, and the role it plays in normal physiology, Lifecore continues to identify opportunities for the use of HA in other medical applications, such as wound care, aesthetic surgery, drug delivery, device coatings, and through pharmaceutical sales to academic and corporate research customers.

(3)

**Utilize manufacturing infrastructure to pursue contract aseptic filling and fermentation opportunities:** Lifecore has made strategic capital investments in its contract manufacturing and development business focusing on extending its aseptic filling capacity and capabilities. It is investing in this segment to meet increasing partner demand and attract new contract filling opportunities. Lifecore is using its manufacturing capabilities to provide contract manufacturing and development services to its partners in the area of sterile pre-filled syringes and fermentation and purification requirements.

(4)

**Maintain flexibility in product development and supply relationships:** Lifecore's vertically integrated development and manufacturing capabilities allow it to establish a variety of contractual relationships with global corporate partners. Lifecore's role in these relationships extends from supplying HA raw materials to providing tech transfer and development services to manufacturing aseptically-packaged, finished sterile products, and to assuming full supply chain responsibilities.

## Results of Operations

**Revenues** (in thousands):

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

Change

November 27, 2016

November 29, 2015

Change

***Packaged Fresh Vegetables***

\$ 97,978    \$ 107,164    (9

%)

\$ 193,923    \$ 210,870    (8

%)

***Food Export***

25,701    22,140    16

%

49,040    44,484    10

%

**Total Apio**

123,679 129,304 (4

%)

242,963 255,354 (5

%)

**Biomaterials**

11,931 10,249 16

%

24,263 19,047 27

%

**Corporate**

255 888 (71

%)

1,033 1,395 (26

%)

**Total Revenues**

\$ 135,865 \$ 140,441 (3

%)

\$ 268,259 \$ 275,796 (3

%)

**Packaged Fresh Vegetables (Apio)**

Apio's Packaged Fresh Vegetables revenues consist of revenues generated from the sale of specialty packaged fresh-cut and whole processed vegetable products that are washed and packaged in Apio's proprietary packaging and sold under the Eat Smart and GreenLine brands and various private labels. In addition, the Packaged Fresh Vegetables

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 and from the sale of BreatheWay packaging to license partners.

The decrease in Apio's Packaged Fresh Vegetables revenues for the three and six months ended November 27, 2016 compared to the same periods last year was primarily due to a 9% decrease in unit volume sales during both periods primarily in Apio's core packaged vegetable business due to the loss of some low margin business beginning in the second half of fiscal year 2016.

*Food Export (Apio)*

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

The increase in Apio's Food Export revenues for the three and six months ended November 27, 2016 compared to the same periods last year was due to a 21% and 16% increase, respectively, in unit volume sales partially offset by a shift in product mix during the quarter and first six months of fiscal year 2017 to lower priced fruit commodity products.

*Biomaterials (Lifecore)*

Lifecore principally generates revenue through the sale of products containing HA. Lifecore primarily sells products to customers in three medical areas: (1) Ophthalmic, which represented approximately 55% of Lifecore's revenues in fiscal year 2016, (2) Orthopedic, which represented approximately 20% of Lifecore's revenues in fiscal year 2016, and (3) Other/Non-HA products, which represented approximately 25% of Lifecore's revenues in fiscal year 2016.

The increase in Lifecore's revenues for the three months ended November 27, 2016 compared to the same period last year was due to a \$2.5 million increase in fermentation sales due to higher sales to existing customers and a \$2.0 million increase in aseptic filling revenues due to new commercial aseptic business and an increase in sales to existing customers, partially offset by a \$2.8 million decrease in development revenues primarily due to the recent approval of a drug product that is now being commercially sold.

The increase in Lifecore's revenues for the six months ended November 27, 2016 compared to the same period last year was due to a \$6.5 million increase in fermentation sales due to higher sales to existing customers and a \$1.5 million increase in aseptic filling revenues due to new commercial aseptic business and an increase in sales to existing customers, partially offset by a \$2.8 million decrease in development revenues primarily due to the recent approval of a drug product that is now being commercially sold.

*Corporate*

Corporate revenues consist of revenues generated from licensing agreements with partners.

The decrease in Corporate revenues for the three and six months ended November 27, 2016 compared to the same period last year was not significant.

**Gross Profit** (in thousands):

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

Change

November 27, 2016

November 29, 2015

Change

***Packaged Fresh Vegetables***

\$ 12,001    \$ 9,979    20

%

\$ 26,407    \$ 23,231    14

%

***Food Export***

1,850    1,676    10

%

2,878    2,679    7

%

***Total Apio***



13,851	11,655	19
--------	--------	----

%

29,285	25,910	13
--------	--------	----

%

**Biomaterials**

4,938	4,881	1
-------	-------	---

%

10,060	8,096	24
--------	-------	----

%

**Corporate**

164	729	(78
-----	-----	-----

%)

752	1,236	(39
-----	-------	-----

%)

**Total Gross Profit**

\$ 18,953	\$ 17,265	10
-----------	-----------	----

%

\$ 40,097	\$ 35,242	14
-----------	-----------	----

%

**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. The Company includes in cost of sales all of the costs related to the sale of products in accordance with GAAP. These costs include the following: raw materials (including produce, packaging, syringes and fermentation and purification supplies), direct labor, overhead (including indirect labor, depreciation, and facility-related costs), and shipping and shipping-related costs. The following are the primary reasons for the changes in gross profit for the three and six months ended November 27, 2016 compared to the same periods last year as

outlined in the table above.

*Packaged Fresh Vegetables (Apio)*

The increase in gross profit for Apio's Packaged Fresh Vegetables business for the three and six months ended November 27, 2016 compared to the same periods last year was primarily due to the gross profit generated from a favorable mix shift in revenues to a greater percentage of revenues coming from higher margin products due primarily to the loss of some low margin business during the second half of fiscal year 2016, operational productivity improvement initiatives, and from the fact that during last year's second quarter Apio incurred \$4.7 million of excess costs from produce shortages. These factors resulted in gross margin increasing to 12.2% during the three months ended November 27, 2016 from 9.3% for the same period last year and increasing to 13.6% during the six months ended November 27, 2016 from 11.0% for the same period last year.

*Food Export (Apio)*

Apio's Food Export business is a buy/sell business that realizes a commission-based margin typically in the 5-10% range. The increase in gross profit for Apio's Food Export business during the three and six months ended November 27, 2016 compared to the same periods last year was primarily due to the 16% and 10% increase, respectively, in revenues. These higher revenues were driven by an abundant supply of export product resulting in a lower margin for the volume sold resulting in gross margins of 7.2% and 5.9% for the three and six months ended November 27, 2016 compared to gross margin of 7.6% and 6.0% for the same periods last year.

*Biomaterials (Lifecore)*

The increase in Lifecore's gross profit for the three months ended November 27, 2016 compared to the same period last year was due to a 16% increase in revenues partially offset by an unfavorable product mix change to a higher percentage of revenue coming from lower margin aseptically filled products compared to higher margin business development service revenues during the same period last year.

The increase in Lifecore's gross profit for the six months ended November 27, 2016 compared to the same period last year was due to a 27% increase in revenues.

*Corporate*

The decrease in Corporate gross profit for the three and months ended November 27, 2016 compared to the same period last year was not significant.

**Operating Expenses** (in thousands):

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

Change

November 27, 2016

November 29, 2015

Change

***Research and Development:***

***Apio***

\$ 286   \$ 255   12

%

\$ 523   \$ 459   14

%

***Lifecore***

1,333   1,086   23

%

2,665   2,312   15

%

**Corporate**

346 302 15

%

715 747 (4

%)

**Total R&D**

1,965 1,643 20

%

3,903 3,518 11

%

**Selling, General and Administrative:**

**Apio**

9,788 8,642 13

%

19,349 16,844 15

%

**Lifecore**

1,304 1,328 (2

%)

2,710 2,570 5

%

**Corporate**

2,632 2,845 (7

%)

5,401    5,565    (3

%)

***Total SG&A***

\$ 13,724    \$ 12,815    7

%

\$ 27,460    \$ 24,979    10

%

***Research and Development***

Landec's Research and Development ("R&D") consisted primarily of product development and commercialization initiatives. R&D efforts at Apio are focused on the Company's proprietary BreatheWay membranes used for packaging produce, with a focus on extending the shelf-life of sensitive vegetables and fruit. In the Lifecore business, the R&D efforts are focused on new products and applications for HA-based and non-HA biomaterials. For Corporate, the R&D efforts are primarily focused on supporting the development and commercialization of new products and new technologies in the food and HA businesses, and on new R&D collaborations with partners.

The increase in R&D expenses for the three and six months ended November 27, 2016 compared to the same periods last year was primarily due to an increase in R&D expenses at Lifecore as a result of a lower percentage of R&D activity being allocated to cost of sales due to lower business development activity this year compared to last year.

***Selling, General and Administrative***

Selling, general and administrative ("SG&A") expenses consist primarily of sales and marketing expenses associated with Landec's product sales and services, business development expenses, and staff and administrative expenses.

The increase in SG&A expenses for the three and six months ended November 27, 2016 compared to the same periods last year was primarily due to an increase in expenses at Apio primarily to ramp up product launches, advertising, and promotions of Apio's existing and new salad kit products to drive current and future sales, and from additional headcount hired over the past year.

**Other** (in thousands):

Three Months Ended

Six Months Ended

November 27, 2016

November 29, 2015

Change

November 27, 2016

November 29, 2015

Change

***Dividend Income***

\$ 413   \$ 413   0

%

\$ 825 \$ 825 0

%

**Interest Income**

3 16 (81

%)

7 47 (85

%)

**Interest Expense**

(380

)

(439

)

(13

%)

(1,032

)

(941

)

10

%

**Loss on Debt Refinancing**

(1,233

)

— N/M (1,233

)



— N/M

***Other Income***

— 200 N/M — 1,000 N/M

***Income Tax Expense***

(693

)

(1,069

)

(35

%)

(2,582

)

(2,760

)

(6

%)

***Non-controlling Interest***

(48

)

(60

)

(20

%)

(81

)

(96

)

(16

%)

#### *Dividend Income*

Dividend income is derived from the dividends accrued on the Company's \$22 million senior preferred stock investment in Windset which yields a cash dividend of 7.5% annually. There was no change in dividend income for the three and six months ended November 27, 2016 compared to the same periods last year.

#### *Interest Income*

The decrease in interest income for the three and six months ended November 27, 2016 compared to the same periods last year was not significant.

#### *Interest Expense*

The decrease and increase in interest expense for the three and six months ended November 27, 2016, respectively, compared to the same periods last year was not significant.

#### *Loss on Debt Refinancing*

The loss on debt refinancing for the three and six months ended November 27, 2016 was primarily due to the one-time write-off of unamortized debt issuance costs and early debt extinguishment prepayment penalties on the Company's then existing debt as of September 23, 2016.

#### *Other Income*

The decrease in other income for the three and six months ended November 27, 2016 was a result of the fair value of the Company's investment in Windset not increasing during these periods in fiscal year 2017 compared to a \$200,000 and \$1.0 million increase, respectively, in fair value for the same periods last year.

*Income Taxes*

The decrease in the income tax expense during the three and six months ended November 27, 2016 compared to the same periods last year was primarily due to a 31% and 5% decrease, respectively, in net income before taxes.

*Non-controlling Interest*

The non-controlling interest consists of the limited partners' equity interest in the net income of Apio Cooling, LP. The decrease in the non-controlling interest for the three and six months ended November 27, 2016 compared to the same periods last year was not significant.

## Liquidity and Capital Resources

As of November 27, 2016, the Company had cash and cash equivalents of \$2.6 million, a net decrease of \$7.3 million from \$9.9 million as of May 29, 2016.

### *Cash Flow from Operating Activities*

Landec generated \$5.5 million of cash from operating activities during the six months ended November 27, 2016, compared to generating \$2.3 million of cash from operating activities for the six months ended November 29, 2015. The primary sources of cash from operating activities during the six months ended November 27, 2016 were from (1) \$4.7 million of net income, (2) \$6.9 million of depreciation/amortization and stock based compensation expenses, and (3) a \$2.3 million net increase in deferred tax liabilities. These sources of cash were partially offset by a net increase of \$9.7 million in working capital. The primary factors which increased working capital during the first six months of fiscal year 2017 were (1) a \$5.0 million decrease in accounts payable due to decreases of \$2.9 million at Lifecore, \$1.7 million at Apio, and \$419,000 at Corporate, all due to the timing of payments at the end of the month of November, (2) a \$3.6 million increase in accounts receivable primarily at Apio as a result of an increase in Food Export receivables which have a longer term than domestic receivables due to increased export sales during October and November 2016, compared to April and May 2016, and (3) a \$2.4 million increase in inventory primarily at Apio for Food Export fruit products in transit at quarter end and an increase in inventory at Lifecore for third quarter sales.

### *Cash Flow from Investing Activities*

Net cash used in investing activities for the six months ended November 27, 2016 was \$4.7 million compared to \$16.0 million for the same period last year. The primary uses of cash in investing activities during the first six months of fiscal year 2017 were for the purchase of \$4.7 million of equipment, primarily to support the growth of the Apio Packaged Fresh Vegetables and Lifecore businesses.

### *Cash Flow from Financing Activities*

Net cash used in financing activities for the six months ended November 27, 2016 was \$8.1 million compared to generating \$5.5 million in cash flow from financing activities for the same period last year. The net cash used in financing activities during the first six months of fiscal year 2017 was primarily due to \$54.7 million of payments on the Company's long-term debt as a result of refinancing all of the Company's debt during the second quarter of fiscal year 2017 and a \$3.5 million payment on the Company's line of credit partially offset by \$50 million proceeds from the

Company refinancing its long-term debt and \$1.5 million proceeds from borrowing under the Company's line of credit.

*Capital Expenditures*

During the six months ended November 27, 2016, Landec purchased equipment to support the growth of the Apio Packaged Fresh Vegetables and Lifecore businesses. These expenditures represented the majority of the \$4.7 million of capital expenditures.

*Debt*

The Company had entered into various loan agreements, primarily with banks, in connection with the acquisition of GreenLine Holding Company in April 2012 and to finance the capacity expansion of its operations, new product development, and other innovation efforts. These individual loans were extinguished during the three months ended November 27, 2016 and replaced with a term loan and revolving commitment.

See Note 7 – Debt of the Notes to Consolidated Financial Statements for further discussion of the Company's debt arrangements.

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

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

There have been no material changes to the Company's market risk during the first six months of fiscal year 2017.

**Item 4. *Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There were no changes in internal controls over financial reporting during the fiscal quarter ended November 27, 2016 that have materially affected, or are reasonably likely to materially affect, internal controls over financial reporting.

## **Part II. Other Information**

### **Item 1. Legal Proceedings**

In the ordinary course of business, the Company is involved in various legal proceedings and claims related to matters such as wage and hour claims.

The Company makes a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least each fiscal quarter and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel, and other information and events pertaining to a particular matter. In management's opinion, resolution of all current matters is not expected to have a material adverse impact on the Company's consolidated financial statements. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company's results of operations or cash flows, or both, in a particular quarter.

During the six months ended November 27, 2016, the Company recorded a charge to income in the amount of \$500,000, or \$0.01 per diluted share after taxes, which combined with amounts previously accrued is the Company's best estimate of settlement charges for all legal matters currently underway.

### **Item 1A. Risk Factors**

There have been no significant changes to the Company's risk factors which are included and described in the Form10-K for the fiscal year ended May 29, 2016 filed with the Securities and Exchange Commission on July 29, 2016.

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

There were no unregistered sales of equity securities or shares repurchased by the Company during the fiscal quarter ended on November 27, 2016.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

Exhibit  
Number

Exhibit Title

10.52

Credit Agreement and Pledge and Security Agreement by and between the Registrant, and JPMorgan Chase Bank, N.A., BMO Harris Bank N.A., and City National Bank, dated September 23, 2016, incorporated herein by reference to Exhibits 10.1 and 10.2 to the Registrant's Current Report on Form 8-K dated September 29, 2016.

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.

101.INS\*\*

XBRL Instance

101.SCH\*\*

XBRL Taxonomy Extension Schema

101.CAL\*\*

XBRL Taxonomy Extension Calculation

101.DEF\*\*

XBRL Taxonomy Extension Definition

101.LAB\*\*

XBRL Taxonomy Extension Labels

101.PRE\*\*

XBRL Taxonomy Extension Presentation

+

Filed herewith.

\*\* XBRL

information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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**SIGNATURES**

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

LANDEC CORPORATION

By:

/s/

Gregory S. Skinner

Gregory S. Skinner

Vice President Finance and Chief Financial Officer

(Principal Financial and Accounting Officer)

Date: January 5, 2017

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