

LANDEC CORP \CA\  
Form 10-Q  
April 05, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

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

For the Fiscal Quarter Ended February 25, 2018, or

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

For the Transition period for \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: **0-27446**

**LANDEC CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**94-3025618**

(IRS Employer Identification Number)

**5201 Great America Parkway, Suite 232**

**Santa Clara, California 95054**

(Address of principal executive offices)

Registrant's telephone number, including area code:

**(650) 306-1650**

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock	The NASDAQ Global Select Stock Market

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

None

(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Large Accelerated Filer	<input type="checkbox"/>	Accelerated Filer	<input checked="" type="checkbox"/>
Non Accelerated Filer	<input type="checkbox"/>	Smaller Reporting Company	<input type="checkbox"/>
Emerging Growth Company	<input type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act \_\_\_\_

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes \_\_\_\_ No X

As of April 2, 2018, there were 27,564,428 shares of Common Stock outstanding.

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**LANDEC CORPORATION**

FORM 10-Q

For the Fiscal Quarter Ended February 25, 2018

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****LANDEC CORPORATION****CONSOLIDATED BALANCE SHEETS****(In thousands except par value)**

	February 25, 2018 (unaudited)	May 28, 2017
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 7,650	\$ 5,409
Accounts receivable, less allowance for doubtful accounts	50,438	47,083
Inventories	28,749	25,290
Prepaid expenses and other current assets	7,614	3,498
Total Current Assets	94,451	81,280
Investment in non-public company, fair value	65,800	63,600
Property and equipment, net	143,362	133,220
Goodwill	54,779	54,779
Trademarks/tradenames, net	16,028	16,028
Customer relationships, net	6,052	6,783
Other assets	5,364	2,918
Total Assets	\$ 385,836	\$ 358,608
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 35,240	\$ 25,868
Accrued compensation	6,732	8,211
Other accrued liabilities	10,369	9,125
Deferred revenue	1,906	310
Line of credit	12,000	3,000
Current portion of long-term debt	4,940	4,940
Total Current Liabilities	71,187	51,454
Long-term debt, net	38,595	42,299
Capital lease obligation, less current portion	3,665	3,731
Deferred taxes, net	15,822	24,581
Other non-current liabilities	6,417	8,391
Total Liabilities	135,686	130,456

Stockholders' Equity:

Common stock, \$0.001 par value; 50,000 shares authorized; 27,555 and 27,499 shares issued and outstanding at February 25, 2018 and May 28, 2017, respectively	28	27
Additional paid-in capital	144,498	141,680
Retained earnings	103,191	84,470
Accumulated other comprehensive income	915	432
Total Stockholders' Equity	248,632	226,609
Non-controlling interest	1,518	1,543
Total Equity	250,150	228,152
Total Liabilities and Stockholders' Equity	\$ 385,836	\$ 358,608

*See accompanying notes.*

## LANDEC CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	February	February	February	February
	25,	26,	25,	26,
	2018	2017	2018	2017
Product sales	\$149,323	\$136,568	\$409,137	\$404,827
Cost of product sales	129,195	113,136	353,971	341,298
Gross profit	20,128	23,432	55,166	63,529
Operating expenses:				
Research and development	3,113	2,014	9,204	5,917
Selling, general and administrative	13,807	15,009	40,786	41,969
Legal settlement charge	—	2,080	—	2,580
Total operating costs and expenses	16,920	19,103	49,990	50,466
Operating income	3,208	4,329	5,176	13,063
Dividend income	413	413	1,238	1,238
Interest income	87	8	161	15
Interest expense	(531 )	(400 )	(1,415 )	(1,432 )
Loss on debt refinancing	—	—	—	(1,233 )
Other income	—	700	2,200	700
Net income before taxes	3,177	5,050	7,360	12,351
Income tax benefit (expense)	12,909	(1,556 )	11,451	(4,138 )
Consolidated net income	16,086	3,494	18,811	8,213
Non-controlling interest benefit (expense)	2	6	(90 )	(75 )
Net income applicable to common stockholders	\$16,088	\$3,500	\$18,721	\$8,138
Basic net income per share	\$0.58	\$0.13	\$0.68	\$0.30
Diluted net income per share	\$0.58	\$0.13	\$0.67	\$0.29
Shares used in per share computation				
Basic	27,547	27,286	27,524	27,252
Diluted	27,918	27,682	27,884	27,608



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Other comprehensive income, net of tax:				
Change in net unrealized gains on interest rate swap (net of tax effect of \$210, \$59, \$552, and \$251)	\$347	\$103	\$483	\$430
Other comprehensive income, net of tax	347	103	483	430
Total comprehensive income	\$16,435	\$3,603	\$19,204	\$8,568

*See accompanying notes.*

## LANDEC CORPORATION

## CONSOLIDATED STATEMENT 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 28, 2017	27,499	\$ 27	\$ 141,680	\$ 84,470	\$ 432	\$ 226,609	\$ 1,543
Issuance of common stock at \$5.63 to \$6.66 per share, net of taxes paid by Landec on behalf of employees	3	—	—	—	—	—	—
Issuance of common stock for vested restricted stock units ("RSUs")	53	1	—	—	—	1	—
Taxes paid by Company for employee stock plans	—	—	(394)	—	—	(394)	—
Stock-based compensation	—	—	3,212	—	—	3,212	—
Payments to non-controlling interest	—	—	—	—	—	—	(115)
Net income	—	—	—	18,721	—	18,721	90
Other comprehensive income, net of tax	—	—	—	—	483	483	—
Balance at February 25, 2018	27,555	\$ 28	\$ 144,498	\$ 103,191	\$ 915	\$ 248,632	\$ 1,518

See accompanying notes.

**LANDEC CORPORATION****Consolidated StatementS of Cash Flows****(Unaudited)****(In thousands)**

	Nine Months Ended	
	February 25,	February 26,
	2018	2017
Cash flows from operating activities:		
Consolidated net income	\$18,811	\$8,213
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,076	7,827
Stock-based compensation expense	3,212	2,842
Deferred taxes	(9,055 )	3,437
Loss on early debt extinguishment	—	1,233
Change in investment in non-public company, fair value	(2,200 )	(700 )
Net loss on disposal of property and equipment	93	264
Changes in current assets and current liabilities:		
Accounts receivable, net	(3,355 )	488
Inventories	(3,459 )	2,262
Prepaid expenses and other current assets	(3,876 )	(137 )
Deposit for workers' compensation collateral	—	(100 )
Accounts payable	9,373	(6,140 )
Accrued compensation	(1,548 )	676
Other accrued liabilities	(449 )	3,419
Deferred revenue	1,475	(403 )
Net cash provided by operating activities	18,098	23,181
Cash flows from investing activities:		
Purchases of property and equipment	(18,533)	(9,488 )
Issuance of note receivable	(2,099 )	—
Proceeds from sales of fixed assets	88	74
Net cash used in investing activities	(20,544)	(9,414 )
Cash flows from financing activities:		
Proceeds from sale of common stock	1	233
Taxes paid by Company for employee stock plans	(394 )	(385 )
Proceeds from long-term debt	—	50,000

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Payments on long-term debt	(3,805 )	(55,966)
Proceeds from lines of credit	18,000	1,500
Payments on lines of credit	(9,000 )	(5,000 )
Payments for debt issuance costs	—	(902 )
Payments for early debt extinguishment penalties	—	(233 )
Payments to non-controlling interest	(115 )	(166 )
Other, net	—	(8 )
Net cash provided by (used in) financing activities	4,687	(10,927)
Net increase in cash and cash equivalents	2,241	2,840
Cash and cash equivalents at beginning of period	5,409	9,894
Cash and cash equivalents at end of period	\$7,650	\$12,734

*See accompanying notes.*

## LANDEC CORPORATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

#### I. 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. Through its O Olive Oil and Vinegar (“O Olive”) division, which the Company acquired on *March 1, 2017*, the Company sells premier California specialty olive oils and wine vinegars under the O brand to natural food, conventional grocery and mass retail stores, primarily in the United States and Canada.

The Company’s technologies, along with its customer relationships and tradenames, are the foundation and key differentiating advantages upon which Landec has built its business.

##### Basis of Presentation

The accompanying unaudited consolidated financial statements of Landec have been prepared in accordance with United States generally accepted accounting principles (“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 of the Company at *February 25, 2018* 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 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 28, 2017*.

The results of operations for the *nine* months ended *February 25, 2018* 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 and its equity investment in the non-public company 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; inventories; self-insurance liabilities; recognition and measurement of current and deferred income tax assets and liabilities; the assessment of recoverability of long-lived assets including intangible assets; the valuation of investments; and the valuation and recognition of stock-based compensation and contingent liabilities.

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.

## Inventories

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

	February 25, 2018	May 28, 2017
Raw materials	\$13,512	\$10,158
Work in progress	3,756	3,447
Finished goods	11,481	11,685
Total	\$28,749	\$25,290

If the cost of the inventories exceeds their net realizable value, provisions are recorded currently to reduce them to net realizable value. The Company also records a provision for slow moving and obsolete inventories based on the estimate of demand for its products.

### **Related Party Transactions**

The Company sells products to and earns license fees from Windset Holdings 2010 Ltd. (“Windset”). During the *three* months ended *February 25, 2018* and *February 26, 2017*, the Company recognized revenues of *\$104,000* and *\$72,000*, respectively. During the *nine* months ended *February 25, 2018* and *February 26, 2017*, the Company recognized revenues of *\$299,000* and *\$265,000*, respectively. These amounts have been included in product sales in the accompanying Consolidated Statements of Comprehensive Income. The related receivable balances of *\$144,000* and *\$388,000* are included in accounts receivable in the accompanying Consolidated Balance Sheets as of *February 25, 2018* and *May 28, 2017*, respectively.

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

### **Debt Issuance Costs**

The Company records its line of credit debt issuance costs as an asset, and as such, *\$120,000* and *\$308,000* were recorded as prepaid expenses and other current assets, and other assets, respectively, as of *February 25, 2018*, and *\$120,000* and *\$399,000*, respectively, as of *May 28, 2017*. The Company records its term debt issuance costs as a contra-liability, and as such, *\$60,000* and *\$155,000* was recorded as current portion of long-term debt, and long-term debt, net, respectively, as of *February 25, 2018* and *\$60,000* and *\$201,000*, respectively, as of *May 28, 2017*. See Note 7 – Debt of the Notes to Consolidated Financial Statements for further information.



## 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.

### *Other 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 on its interest rate swap derivative instrument accounted for as a cash flow hedge. The components of OCI and the changes in accumulated OCI, net of tax, are as follows (in thousands):

Unrealized  
Gains on  
  
Cash Flow  
Hedge

Accumulated OCI, net, as of May 28, 2017	\$ 432
Other comprehensive income before reclassifications, net of tax effect	483
Amounts reclassified from OCI	—
Accumulated OCI, net, as of February 25, 2018	\$ 915

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

### Investment in Non-Public Company

On February 15, 2011, the Company made its initial investment in Windset which is reported as an investment in non-public company, fair value, in the accompanying Consolidated Balance Sheets as of *February 25, 2018* and *May 28, 2017*. The Company has elected to account for its investment in Windset under the fair value option. See Note 3 – Investment in Non-public Company for further information.

### Intangible Assets

The Company's intangible assets are comprised of customer relationships with a finite estimated useful life of *eleven to thirteen* years, and trademarks, tradenames and goodwill with indefinite useful 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 Other accrued liabilities in the accompanying Consolidated Balance Sheets and represents management's best estimate of the amounts that have *not* been paid as of *February 25, 2018* and *May 28, 2017*. It is reasonably possible that the expense the Company ultimately incurs could differ 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 3 – Investment in Non-public Company for further information. The Company also measures its contingent consideration at fair value. See Note 2 – Acquisition of O Olive for further information. 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 *February 25, 2018* and *May 28, 2017*, 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 investment and is included in Other assets in the accompanying Consolidated Balance Sheets.

The fair value of the Company's contingent consideration for the acquisition of O Olive utilizes significant unobservable inputs, including projected earnings before interest, taxes, depreciation and amortization ("EBITDA") and discount rates. As a result, the Company's contingent consideration associated with the O Olive acquisition is considered a Level 3 measurement liability. For the *nine* months ended *February 25, 2018*, the Company reduced its contingent consideration liability from \$5.9 million at *May 28, 2017* to \$5.4 million at *February 25, 2018* due to the change in projected EBITDA and discount rates during the *three* year earn out period ended *May 31, 2020*.

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 change in the fair value of the Company's investment in Windset for the *nine* months ended *February 25, 2018* was due to the Company's 26.9% minority interest in the change in the fair market value of Windset during the period. In determining the fair value of the investment in Windset, the Company utilizes the following significant unobservable inputs in the discounted cash flow models:

	At February 25, 2018	At May 28, 2017
Revenue growth rates	6%	4%
Expense growth rates	5% to 6%	4%
Income tax rates	15%	15%
Discount rates	12%	12%

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 February 25, 2018
10% increase in revenue growth rates	\$ 9,400
10% increase in expense growth rates	\$ (8,800 )
10% increase in income tax rates	\$ (500 )
10% increase in discount rates	\$ (4,200 )

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 February 25, 2018			Fair Value at May 28, 2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets (liabilities):						
Interest rate swap (1)	\$—	\$1,467	\$—	\$—	\$688	\$—
Investment in non-public company	—	—	65,800	—	—	63,600
Contingent consideration liability (2)	—	—	(5,400 )	—	—	(5,900 )
Total	\$—	\$1,467	\$60,400	\$—	\$688	\$57,700

(1) Included in Other assets in the accompanying consolidated balance sheets.

(2) Included in Other non-current liabilities in the accompanying consolidated balance sheets.

## Revenue Recognition

See Note 9 – Business Segment Reporting, for a discussion about the Company’s *four* business segments; namely, Packaged Fresh Vegetables, Food Export, Biomaterials, and Other.

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 accompanying 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. On February 28, 2018, the Company announced its plans to discontinue Cal-Ex by May 27, 2018.

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 65% of Lifecore’s revenues in fiscal year 2017, (2) Orthopedic, which represented approximately 15% of Lifecore’s revenues in fiscal year 2017, and (3) Other/Non-HA products, which represented approximately 20% of Lifecore’s revenues in fiscal year 2017. 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.

O Olive's business, which the Company acquired on *March 1, 2017*, sells premier California specialty olive oils and wine vinegars under the O brand to natural food, conventional grocery and mass retail stores, primarily in the United States and Canada. The revenues of O Olive are included in the Other segment. O Olive's revenue is generally recognized upon shipment of its products to customers. The Company takes title to all products it trades and/or packages, and therefore, records revenues and cost of sales at gross amounts in the accompanying Consolidated Statements of Comprehensive Income.

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 collectability is reasonably 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 R&D 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		Nine Months Ended	
	February	February	February	February
	25,	26,	25,	26,
	2018	2017	2018	2017
Recorded upon shipment	\$141,575	\$125,765	\$373,486	\$339,917
Recorded upon acceptance in foreign port	4,414	7,276	25,982	56,316
Revenue from multiple element arrangements	1,528	2,624	5,230	5,892
Revenue from license fees, R&D contracts and royalties/profit sharing	1,806	903	4,439	2,702
Total	\$149,323	\$136,568	\$409,137	\$404,827

## Legal Contingencies

In the ordinary course of business, the Company is involved in various legal proceedings and 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, estimate settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. Legal fees are expensed in the period in which they are incurred.

Apio has been the target of a union organizing campaign which has included *two* unsuccessful attempts to unionize Apio's Guadalupe, California processing plant. The campaign involved a union and over *100* former and current employees of Pacific Harvest, Inc. and Rancho Harvest, Inc. (collectively "Pacific Harvest"), Apio's labor contractors at its Guadalupe, California processing facility, bringing legal actions before various state and federal agencies, the California Superior Court, and initiating over *100* individual arbitrations against Apio and Pacific Harvest.

The legal actions consisted of *three* main types of claims: (1) Unfair Labor Practice claims ("ULPs") before the National Labor Relations Board ("NLRB"), (2) discrimination/wrongful termination claims before state and federal agencies and in individual arbitrations, and (3) wage and hour claims as part of *two* Private Attorney General Act ("PAGA") cases in state court and in over *100* individual arbitrations.

A settlement of the ULPs among the union, Apio, and Pacific Harvest that were pending before the NLRB was approved on *December 27, 2016* for *\$310,000*. Apio was responsible for half of this settlement, or *\$155,000*. On *May 5, 2017*, the parties to the remaining actions executed a settlement agreement concerning the discrimination/wrongful termination claims and the wage and hour claims which covers all non-exempt employees of Pacific Harvest working at Apio's Guadalupe, California processing facility from *September 2011* through the settlement date. Under the settlement agreement, the plaintiffs are to be paid *\$6.0* million in *three* installments: *\$2.4* million, which was paid on *July 3, 2017*, *\$1.8* million which was paid on *November 22, 2017* and *\$1.8* million which is due in *July 2018*. The Company and Pacific Harvest have each agreed to pay *one* half of the settlement payments. The Company paid the entire *first two* installments of *\$4.2* million and will be reimbursed by Pacific Harvest for its *\$2.1* million portion which is included in Other assets in the accompanying Consolidated Balance Sheets. This receivable will be repaid through monthly payments until fully paid, which the Company expects to occur by *December 2020*. The Company and Pacific Harvest are each required to make *one* half of the *third* installment in *July 2018*. The Company's recourse against non-payment by Pacific Harvest is its security interest in assets owned by Pacific Harvest.

As of *February 25, 2018* and *May 28, 2017*, the Company had accrued \$1.0 million and \$3.2 million, respectively, related to these actions, which is included in Other accrued liabilities in the accompanying Consolidated Balance Sheets.

## Recent Accounting Guidance *Not Yet Adopted*

### *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. Since its original issuance, the FASB has issued several additional related ASUs to address implementation concerns and to further clarify certain guidance within ASU 2014-09. The Company will adopt these updates beginning with the *first* quarter of its fiscal year 2019 and anticipates doing so using the modified retrospective method, which will be applied retrospectively only to the most current reporting period presented.

Currently, the Company is in the process of evaluating the impact of the adoption of ASU 2014-09. As a result, the Company has initially identified the following core revenue streams from its contracts with customers:

- Finished goods product sales (Packaged Fresh Vegetables and O Olive);
- Shipping and handling (Packaged Fresh Vegetables and O Olive);
- Product development and contract manufacturing arrangements (Biomaterials).

The Company’s assessment efforts to date have included reviewing current accounting policies, processes, and systems requirements, as well as assigning internal resources and *third*-party consultants to assist in the process. Additionally, the Company has reviewed historical contracts and other arrangements to identify potential differences that could arise from the adoption of ASU 2014-09. Most notably, the Company is evaluating its current conclusions with respect to contract manufacturing arrangements for its Biomaterials business, as well as the timing of revenue recognition for its product development contract manufacturing arrangements in its Biomaterials business, to determine whether the application of ASU 2014-09 necessitates changes to such reporting. Beyond its core revenue streams, and the items listed above, the Company is also evaluating the impact of ASU 2014-09 on certain ancillary transactions and other arrangements.

Currently, the Company cannot reasonably estimate the impact the application of ASU 2014-09 will have upon its consolidated financial statements. The Company continues to assess the impact of ASU 2014-09, along with industry trends and additional interpretive guidance, on its core revenue streams, and as a result of the continued assessment,

the Company *may* modify its plan of adoption accordingly.

### *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 Company will adopt ASU 2016-02 beginning in the *first* quarter of fiscal year 2020 on a modified retrospective basis.

The Company is currently in the process of evaluating the impact that ASU 2016-02 will have upon its consolidated financial statements and related disclosures. The Company’s assessment efforts to date have included:

- Reviewing the provisions of ASU 2016-02;
- Gathering information to evaluate its lease population and portfolio;
- Evaluating the nature of its real and personal property and other arrangements that *may* meet the definition of a lease; and
- Evaluating systems’ readiness.

As a result of these efforts, the Company currently anticipates that the adoption of ASU 2016-02 will have a significant impact to its long-term assets and liabilities, as, at a minimum, virtually all of its leases designated as operating leases are expected to be reported on the consolidated balance sheets. The pattern of recognition for operating leases within the consolidated statements of comprehensive income is *not* anticipated to significantly change.

### *Income Taxes*

In February 2018, the FASB issued ASU 2018-02, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income* that permits a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act enacted in *December 2017*. The standard is effective for fiscal years beginning after *December 15, 2018*. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of this guidance will have on its consolidated financial statements.

## 2. Acquisition of O Olive

On *March 1, 2017*, the Company purchased substantially all of the assets of O Olive for \$2.5 million in cash plus contingent consideration of up to \$7.5 million over the next *three* years based upon O Olive achieving certain EBITDA targets. All accounting for this acquisition is final.

The potential earn out payment up to \$7.5 million is based on O Olive's cumulative EBITDA over the Company's fiscal years *2018* through *2020*. At the end of each fiscal year, beginning in fiscal year *2018*, the former owners of O Olive will earn the equivalent of the EBITDA achieved by O Olive for that fiscal year in an amount *not* to exceed \$4.6 million over the *three* year period. The former owners can also earn an additional \$2.9 million on a dollar for dollar basis for exceeding \$6.0 million of cumulative EBITDA over the *three* year period. Each quarter the Company performs, with the assistance of a *third* party appraiser, an analysis of O Olive's projected EBITDA over the earnout period. Based on this analysis the Company records a contingent consideration liability, included in Other non-current liabilities. As of *February 25, 2018* and *May 28, 2017* the contingent consideration liability was \$5.4 million and \$5.9 million, respectively, representing the present value of the expected earn out payments. The \$500,000 reduction in the contingent consideration liability was recorded during the *first nine* months of fiscal year *2018* as a reduction to Selling, General and Administrative expenses in the accompanying Consolidated Statements of Comprehensive Income. For this analysis, the Company assumed that the maximum earn out of \$7.5 million would be paid over the *three* year period with over half being earned in fiscal year *2020*.

The operating results of O Olive are included in the Company's financial statements beginning *March 1, 2017*, in the Other segment.

### *Intangible Assets*

The Company identified *two* intangible assets in connection with the O Olive acquisition: trade names and trademarks valued at \$1.6 million, which are considered to be indefinite lived intangible assets and therefore, will *not* be amortized; and customer relationships valued at \$700,000 with an *eleven* year useful life. The Company recorded \$17,000 and \$67,000 of amortization expense from the amortization of the customer relationships intangible during the *three* and *nine* months ended *February 25, 2018*, respectively. The trade name/trademark intangible asset was valued using the relief from royalty valuation method and the customer relationship intangible asset was valued using the excess earnings method.

## 3. 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* common shares and *51,211* junior preferred shares of Windset for \$11 million. After this purchase, the Company’s common shares represent a *26.9%* ownership interest in Windset. The 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 Shareholders’ Agreement between Apio and Windset, as amended, includes a put and call option (the “Put and Call Option”), which can be exercised on or after *March 31, 2022*, 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 shares pay an annual dividend of *7.5%* on the amount outstanding at each anniversary date of the Windset Purchase Agreement. The Senior B preferred shares purchased by Apio have a put feature whereby Apio can sell back to Windset *\$1.5* million of such shares on the *first* anniversary, an additional *\$2.75* million of such 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* month periods ended *February 25, 2018* and *February 26, 2017*, the Company recorded \$412,500 in dividend income. During each of the *nine* month periods ended *February 25, 2018* and *February 26, 2017*, the Company recorded \$1.2 million in dividend income. The increase in the fair market value of the Company's investment in Windset for the *nine* month periods ended *February 25, 2018* and *February 26, 2017* was \$2.2 million and \$700,000, respectively, and is included in Other income in the accompanying Consolidated Statements of Comprehensive Income.

#### 4. Stock-Based Compensation

The Company's stock-based awards include stock option grants and 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 FebruaryFebruary 25, 26,		Nine Months Ended FebruaryFebruary 25, 26,	
	2018	2017	2018	2017
Options	\$ 380	\$ 308	\$ 1,057	\$ 907



RSUs	762	761	2,155	1,935
Total stock-based compensation	\$1,147	\$1,069	\$3,212	\$2,842

The following table summarizes the stock-based compensation by income statement line item (in thousands):

	Three Months Ended February 25, 2018		Nine Months Ended February 25, 2018	
	2017	2017	2017	2017
Cost of sales	\$137	\$124	\$398	\$361
Research and development	41	23	82	69
Selling, general and administrative	969	922	2,732	2,412
Total stock-based compensation	\$1,147	\$1,069	\$3,212	\$2,842

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 method to recognize the fair value of stock-based compensation arrangements.

As of *February 25, 2018*, there was \$5.0 million of total unrecognized compensation expense related to unvested equity compensation awards granted under the Landec incentive stock plans. Total expense is expected to be recognized over the weighted-average period of 2.0 years for stock options and 1.9 years for restricted stock unit awards.

## 5. 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		Nine Months Ended	
	February 25,	February 26,	February 25,	February 26,
	2018	2017	2018	2017
Numerator:				
Net income applicable to Common Stockholders	\$16,088	\$3,500	\$18,721	\$8,138
Denominator:				
Weighted average shares for basic net income per share	27,547	27,286	27,524	27,252
Effect of dilutive securities:				
Stock options and restricted stock units	371	396	360	356
Weighted average shares for diluted net income per share	27,918	27,682	27,884	27,608
Diluted net income per share	\$0.58	\$0.13	\$0.67	\$0.29

For the *three* and *nine* months ended *February 25, 2018*, the computation of the diluted net income per share excludes the impact of options to purchase *1.7* million and *1.5* million shares, respectively of Common Stock as such impacts would be antidilutive for this period.

## 6. Income Taxes

The company's effective tax rate for the *nine* months ended *February 25, 2018* and *February 26, 2017* was a benefit of *154%* and expense of *36%*, respectively. The income tax benefit was *\$11.5* million for the *nine* months ended *February 25, 2018*, and income tax expense was *\$4.1* million for the *nine* months ended *February 26, 2017*. The income tax benefit and discrete benefit for the *nine* months ended *February 25, 2018* is primarily due to a *\$13.9* million discrete benefit that mainly reflects the impact of the re-measurement of net deferred tax liabilities resulting from the permanent reduction in the U.S. statutory corporate tax rate from *35%* to *21%*. The income tax provision for the *nine* months ended *February 26, 2017* was primarily due to state income taxes and incentive stock option expense; partially offset by the domestic manufacturing deduction and research and development credits.

On *December 22, 2017*, the U.S. Government enacted the reconciled tax reform bill, commonly known as the Tax Cuts and Jobs Act of 2017 (the "TCJA"), which became effective on *January 1, 2018*. Among other tax related changes, the Company's federal statutory tax rate has been reduced from 35 %, to an average rate of 29% for the fiscal year ended *May 27, 2018*, and then 21% for fiscal years thereafter. The TCJA also enhances and extends through 2026 the option to claim accelerated depreciation deductions on qualified property; however, the domestic manufacturing deduction, from which the Company has historically benefitted, has been eliminated. Under GAAP, the Company is required to recognize the effects of changes in tax laws and tax rates on deferred tax assets and liabilities in the period in which the new legislation is enacted. At *February 25, 2018*, the Company had *not* completed its accounting for the tax effects of enactment of the TCJA; however, the Company made a reasonable estimate of the effects on its existing deferred tax balances and the *one-time* transition tax.

The changes included in the TCJA are broad and complex and the Company does *not* have all the necessary information to analyze all income tax effects of the TCJA. The above income tax benefit amount is a provisional amount based on a reasonable estimate of the impact of the reduction in the corporate tax rate on our current and deferred tax liabilities. Changes in the estimate of the Company's deferred tax asset and liability activity during fiscal year 2018 could impact the Company's remeasurement of net deferred tax liabilities. The Company will continue to evaluate the TCJA and adjust the provisional amounts as additional information becomes available. The ultimate impact of the TCJA *may* differ from the provisional amounts due to changes in the Company's interpretations and assumptions, as well as additional guidance on the interpretation of the TCJA. The Company will continue to assess its provision for income taxes as future guidance is issued. Although *not* anticipated, revisions to the Company's provision for income taxes will be treated in accordance with the measurement period guidance outlined in Staff Accounting Bulletin No. 118.

As of *February 25, 2018* and *May 28, 2017*, the Company had unrecognized tax benefits of approximately \$472,000 and \$537,000, respectively. Included in the balance of unrecognized tax benefits as of *February 25, 2018* and *May 28, 2017* is approximately \$366,000 and \$419,000, respectively, of tax benefits that, if recognized, would result in an adjustment to the Company's effective tax rate. The Company does *not* expect its unrecognized tax benefits to change significantly within the next *twelve* months.

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 *February 25, 2018* and *May 28, 2017*.

Due to tax attribute carryforwards, the Company is subject to examination for tax years 2015 forward for U.S. tax purposes. The Company is also subject to examination in various state jurisdictions for tax years 2012 forward, *none* of which were individually material.

Our estimated annual effective tax rate *may* be subject to further uncertainty due to the recent changes in U.S. tax rates and tax laws.



## 7. Debt

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

	February 25, 2018	May 28, 2017
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%	\$43,750	\$47,500
Total principal amount of long-term debt	43,750	47,500
Less: unamortized debt issuance costs	(215 )	(261 )
Total long-term debt, net of unamortized debt issuance costs	43,535	47,239
Less: current portion of long-term debt, net	(4,940 )	(4,940 )
Long-term debt, net	\$38,595	\$42,299

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 on 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 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 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 *February 25, 2018*.

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 *February 25, 2018*, the interest rate on the Term Loan was 3.57%. 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 *February 25, 2018*, \$12 million was outstanding on the Revolver at an interest rate of 3.57% under the Libor option.

## 8. Stockholders' Equity

During the *three* months ended *February 25, 2018*, the Company did *not* grant any equity awards. During the *nine* months ended *February 25, 2018*, the Company granted options to purchase *498,000* shares of common stock and awarded *200,000* RSUs.

As of *February 25, 2018*, the Company has reserved *3.1* 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 fiscal year ended *May 28, 2017* and the *nine* months ended *February 25, 2018*, the Company did *not* purchase any shares on the open market.

## 9. Business Segment Reporting

The Company manages its business operations through *three* strategic business units and an Other segment. 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 fruit and vegetables, the majority of which incorporate the BreatheWay specialty packaging for the retail grocery, club store and food services industry. 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 predominantly 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. Other includes licensing and R&D activities from Landec's Intelimer polymers for agricultural products, personal care products and other industrial products and from the operations of the O Olive business which was acquired on *March 1, 2017*. The Other segment also includes corporate 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 by geography are based on the billing address of the customer and were as follows (in millions):

	Three Months Ended February 25, 2018		Nine Months Ended February 25, 2018	
	February 26, 2017	February 26, 2017	February 26, 2017	February 26, 2017
Canada	\$20.3	\$ 16.6	\$56.0	\$ 50.6
Taiwan	\$1.4	\$ 3.0	\$12.7	\$ 27.9
Belgium	\$11.5	\$ 12.9	\$14.3	\$ 19.8
Japan	\$1.6	\$ 1.3	\$4.8	\$ 11.8
Indonesia	\$0.2	\$ 1.5	\$4.0	\$ 6.6
Philippines	\$0.5	\$ 0.6	\$1.5	\$ 6.2
China	\$0.3	\$ 0.4	\$1.6	\$ 1.9
All Other Countries	\$2.1	\$ 2.8	\$6.7	\$ 8.5



Operations by business segment consisted of the following (in thousands):

Three Months Ended February 25, 2018	Packaged	Food	Biomaterials	Other	Total
	Fresh	Export			
	Vegetables				
Net sales	\$ 120,942	\$ 4,414	\$ 22,959	\$ 1,008	\$ 149,323
International sales	\$ 20,285	\$ 4,414	\$ 13,156	\$ 51	\$ 37,906
Gross profit	\$ 7,944	\$ 318	\$ 11,609	\$ 257	\$ 20,128
Net (loss) income	\$ (2,545 )	\$ (216 )	\$ 6,175	\$ 12,674	\$ 16,088
Depreciation and amortization	\$ 2,120	\$ —	\$ 940	\$ 82	\$ 3,142
Dividend income	\$ 413	\$ —	\$ —	\$ —	\$ 413
Interest income	\$ 32	\$ —	\$ —	\$ 55	\$ 87
Interest expense, net	\$ —	\$ —	\$ —	\$ 531	\$ 531
Income tax (benefit) expense	\$ (630 )	\$ (61 )	\$ 1,763	\$ (13,981)	\$ (12,909 )
Three Months Ended February 26, 2017					
Net sales	\$ 105,447	\$ 7,276	\$ 23,532	\$ 313	\$ 136,568
International sales	\$ 16,802	\$ 7,276	\$ 15,024	\$ —	\$ 39,102
Gross profit	\$ 10,114	\$ 558	\$ 12,581	\$ 179	\$ 23,432
Net (loss) income	\$ (2,492 )	\$ (116 )	\$ 7,135	\$ (1,027 )	\$ 3,500
Depreciation and amortization	\$ 1,862	\$ —	\$ 794	\$ 61	\$ 2,717
Dividend income	\$ 413	\$ —	\$ —	\$ —	\$ 413
Interest income	\$ 8	\$ —	\$ —	\$ —	\$ 8
Interest (benefit) expense, net	\$ (77 )	\$ —	\$ —	\$ 477	\$ 400
Income tax (benefit) expense	\$ (594 )	\$ (33 )	\$ 2,031	\$ 152	\$ 1,556
Nine Months Ended February 25, 2018					
Net sales	\$ 330,662	\$ 25,982	\$ 49,236	\$ 3,257	\$ 409,137
International sales	\$ 56,135	\$ 25,982	\$ 19,330	\$ 124	\$ 101,571
Gross profit	\$ 32,404	\$ 1,628	\$ 20,348	\$ 786	\$ 55,166
Net income (loss)	\$ 968	\$ (264 )	\$ 7,280	\$ 10,737	\$ 18,721
Depreciation and amortization	\$ 6,050	\$ —	\$ 2,715	\$ 311	\$ 9,076
Dividend income	\$ 1,238	\$ —	\$ —	\$ 1,238	\$ 1,238
Interest income	\$ 61	\$ —	\$ —	\$ 100	\$ 161
Interest expense, net	\$ —	\$ —	\$ —	\$ 1,415	\$ 1,415
Income tax expense (benefit)	\$ 372	\$ (75 )	\$ 2,110	\$ (13,858)	\$ (11,451 )
Nine Months Ended February 26, 2017					
Net sales	\$ 299,370	\$ 56,316	\$ 47,795	\$ 1,346	\$ 404,827
International sales	\$ 51,073	\$ 56,316	\$ 25,896	\$ —	\$ 133,285
Gross profit	\$ 36,522	\$ 3,436	\$ 22,640	\$ 931	\$ 63,529
Net (loss) income	\$ (419 )	\$ 812	\$ 9,690	\$ (1,945 )	\$ 8,138
Depreciation and amortization	\$ 5,474	\$ 3	\$ 2,225	\$ 125	\$ 7,827
Dividend income	\$ 1,238	\$ —	\$ —	\$ —	\$ 1,238
Interest income	\$ 15	\$ —	\$ —	\$ —	\$ 15

Interest expense, net	\$ 594	\$—	\$ 13	\$825	\$1,432
Income tax (benefit) expense	\$(81	) \$229	\$ 2,769	\$1,221	\$4,138

During the *nine* months ended *February 25, 2018* and *February 26, 2017*, sales to the Company's top *five* customers accounted for *46%* and *43%*, 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 *18%* and *17%* of revenues, respectively, for the *nine* months ended *February 25, 2018*, and *17%* and *14%* respectively, for the *nine* months ended *February 26, 2017*. The Company expects that, for the foreseeable future, a limited number of customers *may* continue to account for a significant portion of its revenues.

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

The following discussion should be read in conjunction with the unaudited consolidated financial statements and accompanying notes included in Part I, Item 1, of this Form 10-Q and the audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in Landec's Annual Report on Form 10-K for the fiscal year ended May 28, 2017.

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 28, 2017. Landec undertakes no obligation to update or revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this report.

## Critical Accounting Policies and Use of Estimates

There have been no material changes to the Company's critical accounting policies which are included and described in the Form 10-K for the fiscal year ended May 28, 2017 filed with the Securities and Exchange Commission on August 10, 2017.

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

## 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. In our Apio, Inc. (“Apio”) Packaged Fresh Vegetables business, we are 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 our Lifecore Biomedical, Inc. (“Lifecore”) biomaterials business, we commercialize products that enable people to stay more active as they grow older. In our O Olive Oil and Vinegar (“O Olive”) business acquired on March 1, 2017, we sell premium California sourced specialty olive oils and wine vinegar products.

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.

Landec has three operating segments – Packaged Fresh Vegetables, Food Export and Biomaterials, each of which is described below and an Other segment. The results of the O Olive business are included in the Other segment in fiscal year 2018 because they are not significant to Landec’s overall results for fiscal year 2018. Financial information concerning each of these segments is summarized in Note 9 – Business Segment Reporting.

Apio operates the Packaged Fresh Vegetables business, which combines our 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 in most cases incorporate 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 distribution 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 Holding 2010 Ltd., a Canadian corporation ("Windset"), for packaging of greenhouse grown cucumbers and peppers.

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 our Biomaterials business and is involved in the development and manufacture of pharmaceutical-grade sodium hyaluronate ("HA") products and providing contract development and aseptic manufacturing services. 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 formulation, filling, and packaging services, as a contract development and manufacturing organization ("CDMO"), for difficult to handle (viscous) medicines filled in finished dose vials and syringes.

O Olive was acquired on March 1, 2017. O Olive, founded in 1995, is based in Petaluma, California, and is a premier producer of California specialty olive oils and wine vinegars. Its products are sold in over 4,600 natural food, conventional grocery and mass retail stores, primarily in the United States and Canada.

Landec was incorporated in California on October 31, 1986 and reincorporated as a Delaware corporation on November 6, 2008. Our common stock is listed on The NASDAQ Global Select Market under the symbol "LNDC". The Company's principal executive offices are located at 5201 Great America Parkway, Suite 232, Santa Clara, California 95054, 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, and it has an Other segment.

### *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 28, 2017, Apio shipped approximately 26 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:

**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 (1) 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.

**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 (2) 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 centers for nationwide delivery of all of its packaged vegetable products in order to meet the next-day delivery needs of customers.

**Expanded Product Line Using Technology and Unique Blends:** Apio, through the use of its BreatheWay (3) packaging technology, is introducing new packaged vegetable products each year. These new product offerings range from various sizes of fresh-cut bagged products, to vegetable trays, to whole produce, to vegetable salads and to snack packs.

(4)

**Products Currently in Approximately 70% of North American Retail Grocery Stores:** Apio has products in approximately 70% of all North American 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 Wild Greens and Quinoa, Beets and Greens, Southwest Salad, and Asian Sesame and more recently a new line of single-serve salads under our new Salad Shake-Ups!™ brand. 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 70% 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. 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.

On March 15, 2017, the Company and Windset agreed to extend their relationship through March 31, 2022.

See Note 3 – 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 an average gross margin between 5 and 10%.

### ***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:

**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.

- (1) 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.

**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.

- (2)

**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.

- (3)

**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.

- (4)

### ***Other***

Included in the Other segment is Corporate and O Olive.



## Results of Operations

### Revenues (in thousands):

	Three Months Ended			Nine Months Ended			
	February	February	Change	February	February	Change	
	25,	26,		25,	26,		
	2018	2017		2018	2017		
<b>Packaged Fresh Vegetables</b>	\$120,942	\$105,447	15 %	\$330,662	\$299,370	10 %	
<b>Food Export</b>	4,414	7,276	(39 %)	25,982	56,316	(54 %)	
<b>Total Apio</b>	125,356	112,723	11 %	356,644	355,686	0 %	
<b>Biomaterials</b>	22,959	23,532	(2 %)	49,236	47,795	3 %	
<b>Other</b>	1,008	313	222 %	3,257	1,346	142 %	
<b>Total Revenues</b>	\$149,323	\$136,568	9 %	\$409,137	\$404,827	1 %	

#### *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, and 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 increase in Apio's Packaged Fresh Vegetables revenues for the three and nine months ended February 25, 2018 compared to the same periods last year was primarily due to a 11% and 7%, respectively, increase in unit volume sales with a majority of the increase in revenues coming from increased sales of our salad products which are higher priced products compared to the Company's lower priced core products whose sales were essentially flat for the three and nine months ended February 25, 2018 compared to the same periods last year.

#### *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 decrease in Apio's Food Export revenues for the three and nine months ended February 25, 2018 compared to the same periods last year was due to a 49% and 57%, respectively, decrease in unit volume sales due to the Company's strategic decision during fiscal year 2018 to discontinue its lower-margin export fruit business. The Company recently announced that it plans to exit the entire Food Export business before the end of fiscal year 2018. As a result, the Food Export's business operations will be reclassified as discontinued operations in the Company's fiscal year end 2018 financial results on a retrospective basis for all periods presented therein.

#### *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 65% of Lifecore's revenues in fiscal year 2017, (2) Orthopedic, which represented approximately 15% of Lifecore's revenues in fiscal year 2017, and (3) Other/Non-HA products, which represented approximately 20% of Lifecore's revenues in fiscal year 2017.

The decrease in Lifecore's revenues for the three months ended February 25, 2018 compared to the same period last year was due to a \$1.2 million decrease in fermentation sales from existing customers partially offset by a \$670,000 increase in aseptic filling revenues from existing customers.

The increase in Lifecore's revenues for the nine months ended February 25, 2018 compared to the same period last year was due to a \$2.1 million increase in business development revenues primarily from new customers and a \$3.9 million increase in aseptic filling revenues from existing customers, partially offset by a \$4.6 million decrease in fermentation sales from existing customers, a portion of which is due to the timing of shipments within the fiscal year.

#### *Other*

Other revenues for the three and nine months ended February 25, 2018 are from the sale of olive oils and vinegars by O Olive and for the three and nine months ended February 26, 2017 are primarily from two licensing agreements with corporate partners.

The increase in Other revenues for the three and nine months ended February 25, 2018 compared to the same periods last year was due to \$1.0 million and \$3.3 million, respectively, of revenues from the O Olive business that was acquired on March 1, 2017 compared to \$313,000 and 1.3 million, respectively, in revenues for the three and nine months ended February 26, 2017 primarily from two license agreements that were completed in August 2016 and December 2016.



**Gross Profit** (in thousands):

	Three Months Ended			Nine Months Ended			
	February 25, 2018	February 26, 2017	Change	February 25, 2018	February 26, 2017	Change	
	2018	2017		2018	2017		
<b>Packaged Fresh Vegetables</b>	\$7,944	\$10,114	(21 %)	\$32,404	\$36,522	(11 %)	
<b>Food Export</b>	318	558	(43 %)	1,628	3,436	(53 %)	
<b>Total Apio</b>	8,262	10,672	(23 %)	34,032	39,958	(15 %)	
<b>Biomaterials</b>	11,609	12,581	(8 %)	20,348	22,640	(10 %)	
<b>Other</b>	257	179	44 %	786	931	(15 %)	
<b>Total Gross Profit</b>	\$20,128	\$23,432	(14 %)	\$55,166	\$63,529	(13 %)	

*General*

There are numerous factors that can influence gross profit including product mix, customer mix, manufacturing costs, volume, sales 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, seeds, 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 nine months ended February 25, 2018 compared to the same period last year as outlined in the table above.

*Packaged Fresh Vegetables (Apio)*

The decrease in gross profit for Apio's Packaged Fresh Vegetables business for the three and nine months ended February 25, 2018 compared to the same periods last year was primarily due to \$3.6 million and \$7.7 million of incremental produce sourcing costs during the three and nine months ended February 25, 2018, respectively, resulting from hurricanes and tropical storms and from unseasonably hot weather in California which negatively impacted produce yields and quality. These incremental produce sourcing costs were partially offset by gross profit resulting from increased salad sales.

*Food Export (Apio)*

Apio's Food Export business is a buy/sell business that realizes an average gross margin from 5-10%. The decrease in gross profit for Apio's Food Export business during the three and nine months ended February 25, 2018 compared to the same periods last year was primarily due to a 39% and 54%, respectively, decrease in revenues due to transitioning away from this low-margin export fruit business.

*Biomaterials (Lifecore)*

The decrease in Lifecore's gross profit for the three months ended February 25, 2018 compared to the same period last year was higher than the 2% decrease in revenues as a result of an unfavorable product mix change to a higher percentage of revenues coming from lower margin aseptically filled product sales than from higher margin fermentation sales during the same period last year.

The decrease in Lifecore's gross profit for the nine months ended February 25, 2018 compared to the same period last year was a result of an unfavorable product mix change to a higher percentage of revenues coming from lower margin aseptically filled product sales than from higher margin fermentation sales during the same period last year. Gross profit also decreased because of the timing of production and thus overhead absorption within the fiscal year.

*Other*

The increase in Other gross profit for the three months ended February 25, 2018 compared to the same period last year was due to the \$257,000 of gross profit for the three months ended February 25, 2018 from O Olive (which was acquired on March 1, 2017) being more than the gross profit primarily from two license agreements for the same period last year because one of the licensing agreements was completed in the first quarter (August) of last year and therefore generated no gross profit during the third quarter of last year and the other was completed early in the third quarter (December) of last year.

The decrease in Other gross profit for the nine months ended February 25, 2018 compared to the same period last year was due to the \$786,000 of gross profit for the nine months ended February 25, 2018 from O Olive (which was acquired on March 1, 2017) being less than the gross profit primarily from two license agreements for the same period last year which were completed in August 2016 and December 2016.

**Operating Expenses** (in thousands):

	Three Months Ended			Nine Months Ended		
	February 25, 2018	February 26, 2017	Change	February 25, 2018	February 26, 2017	Change
<b>Research and Development:</b>						
<i>Apio</i>	\$ 1,339	\$ 339	295 %	\$ 3,805	\$ 862	341 %
<i>Lifecore</i>	1,406	1,362	3 %	4,108	4,027	2 %
<i>Other</i>	368	313	18 %	1,291	1,028	26 %
<b>Total R&amp;D</b>	<b>3,113</b>	<b>2,014</b>	<b>55 %</b>	<b>9,204</b>	<b>5,917</b>	<b>56 %</b>
<b>Selling, General and Administrative:</b>						
<i>Apio</i>	8,586	10,447	(18 %)	25,926	29,296	(12 %)
<i>Lifecore</i>	1,444	1,362	6 %	4,387	4,072	8 %
<i>Other</i>	3,777	3,200	18 %	10,473	8,601	22 %
<b>Total SG&amp;A</b>	<b>\$ 13,807</b>	<b>\$ 15,009</b>	<b>(8 %)</b>	<b>\$ 40,786</b>	<b>\$ 41,969</b>	<b>(3 %)</b>

*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 new product innovation and 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 Other, the R&D efforts are primarily focused on supporting the development and commercialization of new products and new technologies in the Company's new natural food business.

The Company's ability to compete successfully depends heavily upon its ability to ensure a continual and timely flow of innovative and competitive products, services, and technologies to the marketplace. The Company continues to develop new products and to expand the range of its product offerings through R&D.

R&D expenses include expenditures for new product and manufacturing process innovation, or a significant improvement to an existing product or process, which consist of expenses incurred in performing R&D activities, including compensation and benefits for R&D employees, facilities expenses, overhead expenses, cost of laboratory and innovation supplies, third-party formulation expenses, fees paid to contract research organizations and other consultants, stock-based compensation for R&D employees, and other outside expenses.

The increase in R&D expenses for the three and nine months ended February 25, 2018 compared to the same periods last year was due to a significant increase in product development activities at Apio driven primarily from the hiring of a VP of Innovation and R&D during the fourth quarter of fiscal year 2017 and the subsequent staff hiring in that department, coupled with an increase in product development expenses at Apio and in new natural foods products at Corporate.

*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 decrease in SG&A expenses for the three and nine months ended February 25, 2018 compared to the same periods last year was due to a decrease in SG&A at Apio as a result of (1) a decrease in marketing expenses, (2) legal fees and legal settlement costs incurred during the three and nine months ended February 26, 2017 of last year from the labor-related lawsuits settled during fiscal year 2017 and (3) severance costs incurred in the third quarter of fiscal year 2017. The decrease at Apio was partially offset by an increase in SG&A expenses in Other resulting from (1) an increase in stock-based compensation from equity grants, (2) new business development activities and (3) \$360,000 and \$1.1 million, respectively, of SG&A expenses for the three and nine months ended February 25, 2018 incurred by O Olive which was acquired on March 1, 2017. For the nine months ended February 25, 2018, these increases in SG&A in Other were partially offset by a \$500,000 reduction in the contingent consideration liability associated with the O Olive acquisition which was recorded in the first half of fiscal year 2018.

**Other** (in thousands):

	Three Months Ended			Nine Months Ended			
	February 25, 2018	February 26, 2017	Change	February 25, 2018	February 26, 2017	Change	
<b>Dividend Income</b>	\$413	\$413	0 %	\$1,238	\$1,238	0 %	
<b>Interest Income</b>	87	8	988 %	161	15	973 %	
<b>Interest Expense</b>	(531 )	(400 )	33 %	(1,415 )	(1,432 )	(1 %)	
<b>Loss on Debt Refinancing</b>	—	—	N/M	—	(1,233 )	N/M	
<b>Other Income</b>	—	700	N/M	2,200	700	N/M	
<b>Income Tax Benefit (Expense)</b>	12,909	(1,556 )	N/M	11,451	(4,138 )	N/M	
<b>Non-controlling Interest Expense</b>	2	6	(63 %)	(90 )	(75 )	20 %	

#### *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 nine months ended February 25, 2018 compared to the same periods last year.

#### *Interest Income*

The increase in interest income for the three and nine months ended February 25, 2018 compared to the same periods last year was not significant.

#### *Interest Expense*

The increase in interest expense for the three months ended February 25, 2018 compared to the same period last year was primarily due to lower capitalization of interest for long-term capital projects during the third quarter of fiscal year 2018 compared to the third quarter of fiscal year 2017.



The decrease in interest expense for the nine months ended February 25, 2018 compared to the same period last year was not significant.

*Loss on Debt Refinancing*

The loss on debt refinancing for the nine months ended February 26, 2017 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.

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### *Other Income*

The decrease in other income for the three months ended February 25, 2018 compared to the same period last year was a result of the change in the fair value of the Company's investment in Windset which did not increase for the three months ended February 25, 2018 compared to a \$700,000 increase for the three months ended February 26, 2017.

The increase in other income for the nine months ended February 25, 2018 compared to the same period last year was a result of the change in the fair value of the Company's investment in Windset which increased \$2.2 million for the nine months ended February 25, 2018 compared to an increase of \$700,000 for the nine months ended February 26, 2017.

### *Income Taxes*

As a result of the income tax benefit from the Tax Cuts and Jobs Act of 2017 (the "TCJA"), income taxes for the three and nine months ended February 25, 2018 reflected a significant benefit (please refer to Note 6 for more details) as compared to the three and nine months ended February 26, 2017 which reflected a tax expense based on pre-tax income for those periods.

### *Non-controlling Interest*

The non-controlling interest consists of the limited partners' equity interest in the net income of Apio Cooling, LP. The change in the non-controlling interest for the three and nine months ended February 25, 2018 compared to the same periods last year was not significant.

### **Liquidity and Capital Resources**

As of February 25, 2018, the Company had cash and cash equivalents of \$7.7 million, a net increase of \$2.3 million from \$5.4 million as of May 28, 2017.

*Cash Flow from Operating Activities*

Landec generated \$18.1 million of net cash from operating activities during the nine months ended February 25, 2018, compared to \$23.2 million of net cash generated from operating activities for the same period last year. The primary sources of net cash from operating activities during the nine months ended February 25, 2018 were from (1) \$18.8 million of net income and (2) \$12.3 million of depreciation/amortization and stock based compensation expenses. These sources of cash were offset by (1) a \$9.1 million decrease in deferred taxes, (2) a \$2.2 million increase in the fair market value of the Company's Windset investment and (3) a net increase of \$1.8 million in working capital.

The primary factors which increased working capital during the first nine months of fiscal year 2018 were (1) a \$3.4 million increase in accounts receivable due primarily to a \$2.6 million increase in accounts receivable at Apio due to sales in February 2018 being \$3.5 million higher than May 2017, (2) a \$3.5 million increase in inventories due primarily to a \$1.3 million increase at Apio from an increase in raw materials for expected increases in salad sales during the fourth quarter and from a \$1.9 million increase at Lifecore due to certain shipments planned for the third quarter shifting to the fourth quarter of fiscal year 2018, and (3) a \$3.9 million increase in prepaid expenses and other current assets due to a \$3.3 million increase in prepaid taxes resulting from the new tax reform. The increases in working capital were partially offset by a \$9.3 million increase in accounts payable due primarily to an \$8.7 million increase at Apio from a \$6.8 million increase in cost of sales in February 2018 compared to May of 2017 and from the timing of payments.

*Cash Flow from Investing Activities*

Net cash used in investing activities for the nine months ended February 25, 2018 was \$20.5 million compared to \$9.4 million for the same period last year. The primary uses of cash in investing activities during the first nine months of fiscal year 2018 were for the purchase of \$18.5 million of equipment, primarily to support the growth of the Apio Packaged Fresh Vegetables and Lifecore businesses and from the issuance of a \$2.1 million note receivable.

*Cash Flow from Financing Activities*

Net cash provided by financing activities for the nine months ended February 25, 2018 was \$4.7 million compared to net cash used in financing activities of \$10.9 million for the same period last year. The net cash provided by financing activities during the first nine months of fiscal year 2018 was due to \$9.0 million of net borrowings under the Company's line of credit. These borrowings were partially offset by \$3.8 million of payments on the Company's long-term debt.

### *Capital Expenditures*

During the nine months ended February 25, 2018, Landec purchased equipment to support the growth of the Apio Packaged Fresh Vegetables and Lifecore businesses. These expenditures represented the majority of the \$18.5 million of capital expenditures in the period.

### *Debt*

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.

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 nine months of fiscal year 2018.

### **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 February 25, 2018 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.

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, estimate settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. Legal fees are expensed in the period in which they are incurred.

Apio has been the target of a union organizing campaign which has included two unsuccessful attempts to unionize Apio's Guadalupe, California processing plant. The campaign involved a union and over 100 former and current employees of Pacific Harvest, Inc. and Rancho Harvest, Inc. (collectively "Pacific Harvest"), Apio's labor contractors at its Guadalupe, California processing facility, bringing legal actions before various state and federal agencies, the California Superior Court, and initiating over 100 individual arbitrations against Apio and Pacific Harvest.

The legal actions consisted of three main types of claims: (1) Unfair Labor Practice claims ("ULPs") before the National Labor Relations Board ("NLRB"), (2) discrimination/wrongful termination claims before state and federal agencies and in individual arbitrations, and (3) wage and hour claims as part of two Private Attorney General Act ("PAGA") cases in state court and in over 100 individual arbitrations.

A settlement of the ULPs among the union, Apio, and Pacific Harvest that were pending before the NLRB was approved on December 27, 2016 for \$310,000. Apio was responsible for half of this settlement, or \$155,000. On May 5, 2017, the parties to the remaining actions executed a settlement agreement concerning the discrimination/wrongful termination claims and the wage and hour claims which covers all non-exempt employees of Pacific Harvest working at Apio's Guadalupe, California processing facility from September 2011 through the settlement date. Under the settlement agreement, the plaintiffs are to be paid \$6.0 million in three installments: \$2.4 million, which was paid on July 3, 2017, \$1.8 million which was paid on November 22, 2017 and \$1.8 million which is due in July 2018. The Company and Pacific Harvest have each agreed to pay one half of the settlement payments. The Company paid the entire first two installments of \$4.2 million and will be reimbursed by Pacific Harvest for its \$2.1 million portion which is included in Other assets in the accompanying Consolidated Balance Sheets. This receivable will be repaid through monthly payments until fully paid, which the Company anticipates will occur by December 2020. The Company and Pacific Harvest are each required to make one half of the third installment in July 2018. The Company's recourse against non-payment by Pacific Harvest is its security interest in assets owned by Pacific Harvest.

As of February 25, 2018 and May 28, 2017, the Company had accrued \$1.0 million and \$3.2 million, respectively, related to these actions, which is included in Other accrued liabilities in the accompanying Consolidated Balance Sheets.

**Item 1A. Risk Factors**

Our estimated annual effective tax rate may be subject to further uncertainty due to the recent changes in U.S. tax rates and tax laws. Other than this item, there have been no significant changes to the Company's risk factors which are included and described in the Form 10-K for the fiscal year ended May 28, 2017 filed with the Securities and Exchange Commission on August 10, 2017.

**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 February 25, 2018.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable

**Item 5. Other Information**

None.

**Item 6. Exhibits**

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

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.



**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 of  
Finance and Chief  
Financial Officer  
(Principal Financial  
and Accounting  
Officer)

Date: April 5, 2018