LANDEC CORP \CA\
Form 10-Q
April 07, 2017

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Fiscal Quarter Ended February 26, 2017, or

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

For the transition period from _____ to _________.

Commission file number: **0-27446**

LANDEC CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**94-3025618**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

3603 Haven Avenue

Menlo Park, California 94025

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code:

(650) 306-1650

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

Yes _X_ 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 _X_ No___

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

Large Accelerated Filer ___	Accelerated Filer _X_
Non Accelerated Filer ___	Smaller Reporting Company ___

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

Yes __ No _X_

As of March 31, 2017, there were 27,305,179 shares of Common Stock outstanding.

LANDEC CORPORATION

FORM 10-Q

For the Fiscal Quarter Ended February 26, 2017

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LANDEC CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands except par value)

	February 26, 2017 (unaudited)	May 29, 2016 As Adjusted (1)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 12,734	$ 9,894
Accounts receivable, less allowance for doubtful accounts	45,918	46,406
Inventories	23,273	25,535
Prepaid expenses and other current assets	4,650	4,468
Total Current Assets	86,575	86,303
Investment in non-public company, fair value	63,400	62,700
Property and equipment, net	123,005	120,880
Goodwill, net	49,620	49,620
Trademarks/tradenames, net	14,428	14,428
Customer relationships, net	6,304	6,968
Other assets	2,804	1,754
Total Assets	$ 346,136	$ 342,653
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 24,764	$ 30,904
Accrued compensation	6,136	5,460
Other accrued liabilities	10,904	7,772
Deferred revenue	429	832
Line of credit	—	3,500
Current portion of long-term debt, net	4,940	7,873
Total Current Liabilities	47,173	56,341
Long-term debt, net	43,534	45,972
Capital lease obligation, less current portion	3,751	3,804
Deferred taxes, net	25,507	22,442

Other non-current liabilities	2,031	1,744
Total Liabilities	121,996	130,303
Stockholders' Equity:		
Common stock, $0.001 par value; 50,000 shares authorized; 27,305 and 27,148 shares issued and outstanding at February 26, 2017 and May 29, 2016, respectively	27	27
Additional paid-in capital	140,134	137,244
Retained earnings	82,018	73,457
Accumulated other comprehensive income	430	—
Total Stockholders' Equity	222,609	210,728
Non-controlling interest	1,531	1,622
Total Equity	224,140	212,350
Total Liabilities and Stockholders' Equity	$ 346,136	$ 342,653

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

See accompanying notes.

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LANDEC CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	February 26, 2017	February 28, 2016	February 26, 2017	February 28, 2016
Product sales	$136,568	$129,990	$404,827	$405,786
Cost of product sales	113,136	117,059	341,298	357,613
Gross profit	23,432	12,931	63,529	48,173
Operating expenses:				
Research and development	2,014	1,895	5,917	5,413
Selling, general and administrative	15,009	10,659	41,969	35,638
Legal settlement charge	2,080	—	2,580	—
Impairment of GreenLine tradename	—	34,000	—	34,000
Total operating costs and expenses	19,103	46,554	50,466	75,051
Operating income (loss)	4,329	(33,623)	13,063	(26,878)
Dividend income	413	413	1,238	1,238
Interest income	8	17	15	64
Interest expense, net	(400)	(484)	(1,432)	(1,425)
Loss on debt refinancing	—	—	(1,233)	—
Other income	700	—	700	1,000
Net income (loss) before taxes	5,050	(33,677)	12,351	(26,001)
Income tax (expense) benefit	(1,556)	12,510	(4,138)	9,750
Consolidated net income (loss)	3,494	(21,167)	8,213	(16,251)
Non-controlling interest income (expense)	6	(23)	(75)	(119)
Net income (loss) and comprehensive income applicable to common stockholders	$3,500	$(21,190)	$8,138	$(16,370)
Basic net income (loss) per share	$0.13	$(0.78)	$0.30	$(0.61)
Diluted net income (loss) per share	$0.13	$(0.78)	$0.29	$(0.61)
Shares used in per share computation				
Basic	27,286	27,054	27,252	27,026
Diluted	27,682	27,054	27,608	27,026

Other comprehensive income, net of tax:

Change in net unrealized gains on interest rate swap (net of tax effect of $59, $0, $251, and $0)	$103	$—	$430	$—
Other comprehensive income, net of tax	103	—	430	—
Total comprehensive income (loss)	$3,603	$(21,190)	$8,568	$(16,370)

See accompanying notes.

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LANDEC CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

(in thousands, except per share amounts)

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Total Stockholders'	Non-controlling
	Shares	Amount	Capital	Earnings	Income	Equity	Interest
Balance at May 29, 2016	27,148	$ 27	$ 137,244	$ 73,457	$ —	$ 210,728	$ 1,622
Cumulative-effect adjustment - ASU 2016-09 adoption (1)	—	—	200	423	—	623	—
Issuance of common stock at $5.63 to $6.66 per share, net of taxes paid by Landec on behalf of employees	86	—	233	—	—	233	—
Issuance of common stock for vested restricted stock units ("RSUs")	71	—	—	—	—	—	—
Taxes paid by Company for stock swaps and RSUs	—	—	(385)	—	—	(385)	—
Stock-based compensation	—	—	2,842	—	—	2,842	—
Payments to non-controlling interest	—	—	—	—	—	—	(166)
Net income	—	—	—	8,138	—	8,138	75
Other comprehensive income, net of tax	—	—	—	—	430	430	—
Balance at February 26, 2017	27,305	$ 27	$ 140,134	$ 82,018	$ 430	$ 222,609	$ 1,531

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

See accompanying notes.

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LANDEC CORPORATION

Consolidated StatementS of Cash Flows

(Unaudited)

(In thousands)

	Nine Months Ended February 26, 2017	February 28, 2016 As Adjusted (1)
Cash flows from operating activities:		
Consolidated net income (loss)	$ 8,213	$ (16,251)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,827	6,486
Stock-based compensation expense	2,842	2,581
Deferred taxes	3,437	(10,560)
Loss on early debt extinguishment	1,233	—
Change in investment in non-public company, fair value	(700)	(1,000)
Net loss (gain) on disposal of property and equipment	264	(20)
Impairment of GreenLine tradename	—	34,000
Changes in current assets and current liabilities:		
Accounts receivable, net	488	3,555
Inventories	2,262	(2,135)
Prepaid expenses and other current assets	(137)	(14)
Deposit for workers' compensation collateral	(100)	(225)
Accounts payable	(6,140)	(9,918)
Accrued compensation	676	(2,536)
Other accrued liabilities	3,419	2,158
Deferred revenue	(403)	309
Net cash provided by operating activities	23,181	6,430
Cash flows from investing activities:		
Purchases of property and equipment	(9,488)	(26,159)
Deposit on capital lease	—	(850)
Proceeds from sales of fixed assets	74	127
Net cash used in investing activities	(9,414)	(26,882)
Cash flows from financing activities:		
Proceeds from sale of common stock	233	282
Taxes paid by Company for stock swaps and RSUs	(385)	—

Proceeds from long-term debt	50,000	26,748
Payments on long-term debt	(55,966)	(12,150)
Proceeds from lines of credit	1,500	19,500
Payments on lines of credit	(5,000)	(19,500)
Payments for debt issuance costs	(902)	—
Payments for early debt extinguishment penalties	(233)	—
Payments to non-controlling interest	(166)	(248)
Other, net	(8)	(93)
Net cash (used in) provided by financing activities	(10,927)	14,539
Net increase (decrease) in cash and cash equivalents	2,840	(5,913)
Cash and cash equivalents at beginning of period	9,894	14,127
Cash and cash equivalents at end of period	$12,734	$8,214
Supplemental disclosures of noncash investing and financing activities:		
Facility acquired under a capital lease	$—	$3,775

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

See accompanying notes.

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LANDEC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

Organization

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

Basis of Presentation

The accompanying unaudited consolidated financial statements of Landec have been prepared in accordance with 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 26, 2017 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 29, 2016. Certain prior period data has been reclassified in the consolidated financial statements and accompanying footnotes to conform to current period presentation.

The results of operations for the nine months ended February 26, 2017 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; 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 and inventory; the valuation of investments; and the valuation and recognition of stock-based compensation.

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

Cash and Cash Equivalents

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

Debt Issuance Costs

The Company records its line of credit debt issuance costs as an asset, and as such, $120,000 and $431,000 was recorded as prepaid expenses and other current assets and other assets, respectively, as of February 26, 2017. The Company records its term debt issuance costs as a contra-liability, and as such, $60,000 and $216,000 was recorded as current portion of long-term debt and long-term debt, respectively, as of February 26, 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.

For additional information refer to Note 10 – Comprehensive Income.

Investment in Non-Public Company

On February 15, 2011, Apio purchased 150,000 senior preferred shares for $15 million and 201 common shares for $201 that were issued by Windset Holdings 2010 Ltd., a Canadian corporation (“Windset”). On July 15, 2014, Apio increased its investment in Windset by purchasing an additional 68 common shares and 51,211 junior preferred shares of Windset for $11 million. On October 29, 2014, Apio purchased an additional 70,000 senior preferred shares of Windset for $7 million. These investments are reported as an investment in non-public company, fair value, in the accompanying Consolidated Balance Sheets as of February 26, 2017 and May 29, 2016. The Company has elected to account for its investment in Windset under the fair value option. See Note 2 – 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 twelve to thirteen years, and trademarks, tradenames and goodwill with indefinite lives.

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

Fair Value Measurements

The Company uses fair value measurement accounting for financial assets and liabilities and for financial instruments and certain other items measured at fair value. The Company has elected the fair value option for its investment in a non-public company. See Note 2 – Investment in Non-public Company 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 26, 2017 and May 29, 2016, the Company held certain assets that are required to be measured at fair value on a recurring basis, including its interest rate swap and its minority interest investment in Windset.

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

The Company has elected the fair value option of accounting for its investment in Windset. The calculation of fair value utilizes significant unobservable inputs, including projected cash flows, growth rates, and discount rates. As a result, the Company’s investment in Windset is considered to be a Level 3 measurement investment. The change in the fair value of the Company’s investment in Windset for the nine months ended February 26, 2017 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:

	February 26, 2017	May 29, 2016
Revenue growth rates	4%	4%
Expense growth rates	4%	4%
Income tax rates	15%	15%
Discount rates	12%	12.5%

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 26, 2017
10% increase in revenue growth rates	$ 7,200
10% increase in expense growth rates	$ (2,100)
10% increase in income tax rates	$ (400)
10% increase in discount rates	$ (4,300)

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 26, 2017			Fair Value at May 29, 2016		
Assets:	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Interest rate swap (1)	$—	$681	$—	$—	$ —	$—
Investment in non-public company	—	—	63,400	—	—	62,700
Total	$—	$681	$63,400	$—	$ —	$62,700

(1) Recorded in Other assets.

Revenue Recognition

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

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