

September 20, 2013

Dear clients and colleagues,

Innovation is a major investment theme embraced by our portfolio. Many of our holdings provide innovative products and services in a wide range of industries such as packaging, machinery, electronics, internet software, equipment, healthcare, alternative energy and specialty chemicals. Innovation creates competitive edge, helping the company gain market share and enjoy superior margin, which eventually adds to shareholder value.

It does not have to be rocket science. Innovation can appear in very simple ways in daily life. For example, as people are more health-conscious, they eat more fresh vegetables instead of canned or frozen ones. At the same time, convenience remains the top food trend in recent years. You may have noticed more and more clean vegetable packages ready to eat or cook. How many days can you keep the washed and cut vegetables fresh? It used to be a few days. But a US company managed to extend the shelf-life to 20 days. It's called Landec Corporation, a new addition to our portfolio.

**Landec Corporation (LNDC US - \$13.28)**

[www.landec.com](http://www.landec.com)

#### ***Business Overview***

Landec is a materials science company focused on healthy living. It leverages its proprietary polymer technologies to food and biomedical products. This technology optimizes the rate at which oxygen and carbon dioxide flow in and out of the packaging. Its polymers can change subject to changes in temperature and pH, etc.

Landec is the #1 player in fresh-cut specialty packaged vegetables in the US. Its clientele covers all major clubs and grocery markets. It sells 16M cartons of fresh produce a year. The business model is to outsource growing to farmers, and process vegetables in its own facilities. Eat Smart and Greenline are two major brands.

Besides the steadily growing food business, it is also engaged in rapidly growing biomedical business, where it is a premium supplier of hyaluronic-based materials and medical products to ophthalmic, orthopedic, and veterinary markets worldwide.

#### ***Target Market***

The fresh cut produce market size in the US is \$800M, growing at 6-8% annually. Landec's food business grew 15% in FY2013, substantially outpacing the industry. Its target market for biomedical business is at \$1B, growing at double digits annually.

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### **Management**

Management owns 8% of the company. Very stable and experienced team. The founder is still the CEO since inception in 1991. He was an early v-p at Genentech and the founder of Molecular Devices. The CFO joined in 1996.

### **Competition**

In the food business, Landec competes with two private US companies whose combined sales are half of Landec's. In the biomedical business, it has no competitor in the ophthalmic field, and in other fields competes with large players such as Novartis and Genzyme.

### **Competitive advantages**

- Proprietary polymer technology helps gain market share.
- Dominant niche player: It has the 5<sup>th</sup> largest food growing business in the US and 80% penetration in Costco clubs.
- Market leader in branded business:
  - #1 in fresh-cut vegetables and green beans
  - #1 in hydroponic greenhouse technology
  - #1 in ophthalmology viscoelastics

### **Growth strategy**

- New products: Over 100 new food SKUs were launched in FY2013, +10% y/y.
- Cross selling among clubs and grocery stores.
- Acquire good companies and retain management.

### **Risks**

- Food business: Bad weather increases sourcing costs. Price competition.
- Biomaterial business: Timing of regulatory approval for new products.

### **Market Data**

Market Cap \$352M, Net debt / ebitda 1.0x, p/e (2014/5) 15.5x, ev/sales (2014/5) 0.8x, ev/ebitda (2014/5) 10.1x.

Have a nice weekend.

The Global Alpha Team

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