UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED JUNE 30, 2000.

/ / 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: 0-16159

LECTEC CORPORATION
(Exact name of registrant as specified in its charter)

MINNESOTA	41-1301878
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
10701 RED CIRCLE DRIVE, MINNETONKA, MINNESOTA (Address of principal executive offices)	55343 (Zip Code)

Registrant's telephone number, including area code: (952) 933-2291

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value $0.01 per share.

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 the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein; and will not be contained, to the best of the Registrant's knowledge, in the definitive proxy statement incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K. [ ]

The aggregate market value of the Common Stock held by non-affiliates of the Registrant as of September 20, 2000 was $6,513,235 based upon the last reported sale price of the Common Stock at that date by the Nasdaq Stock Market.

The number of shares outstanding of the Registrant's Common Stock as of September 20, 2000 was 3,904,465 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-K incorporates by reference information from the Registrant's Proxy Statement for its Annual Meeting of Shareholders to be held November 16, 2000.

PART I

ITEM 1. BUSINESS

GENERAL

LecTec Corporation (the "Company") designs, manufactures and markets diagnostic electrocardiograph ("ECG") electrodes, conductive and non-conductive adhesive hydrogels, and patches for the topical application of over-the-counter ("OTC") drugs. The Company markets and sells its products to medical products distributors, consumers through retail outlets (food, chain drug and mass merchandise stores), consumer products companies and original equipment manufacturers ("OEM"s). All of the products manufactured by the Company are designed to be highly compatible with skin.

The Company developed one of the first solid gel disposable ECG electrodes which did not require the use of aqueous conductive gels in order to maintain contact with the skin. The Company has since continued to develop, manufacture and market electrodes as well as hydrogels and OTC topical therapeutic patches. A hydrogel is a gel-like material having an affinity for water and similar compounds. These gels are ideal for electrical conductivity and skin compatibility. The Company holds multiple domestic and foreign patents.

Effective January 14, 1999, the Company was certified as meeting the requirements of ISO 9001 and EN46001 quality system standards. Certification was

granted by TUV Product Service GmbH. Meeting these standards, particularly EN46001, confirms that the Company has achieved the highest level of quality systems compliance demonstrated by world-class design and manufacturing firms. For medical devices, EN46001 is awarded only to those companies which satisfy the rigorous standards of ISO 9001 and comply with the European Union's Medical Device Directive.

The Company, through its research and development efforts, is investigating new products for topical delivery of OTC drugs, and new conductive adhesive hydrogel polymers. In addition, existing technologies are being refined to focus on new consumer products targeting new retail customers and new markets.

The Company was organized in 1977 as a Minnesota corporation. Its principal executive office is located at 10701 Red Circle Drive, Minnetonka, Minnesota 55343, and its telephone number is (952) 933-2291.

PRODUCTS

The Company's core competency is skin interface technology. This competency results in products which are chemically compatible with human skin, thereby reducing skin irritation and reducing damage to the skin as well as the risk of infection. The electrical properties, adhesive characteristics, dimensions, drug stability, shelf life and manufacturability of the Company's products are highly consistent and reproducible from product to product.

CONDUCTIVE PRODUCTS

The Company's conductive products include diagnostic electrodes and electrically conductive adhesive hydrogels.

The Company applies its patented conductive, skin compatible, adhesive hydrogel technology to cardiac diagnostic electrodes. The Company's patented natural and synthetic-based hydrogel polymers are self-adherent and are capable of being made electrically conductive. Using natural-based polymers, the Company developed the first solid gel disposable diagnostic ECG electrodes.

The solid gel design of the Company's electrodes provides more consistent electrical performance and eliminates clean-up time for the clinician. Currently the Company has three different types of diagnostic electrodes: LecTec 1000 Series, a disposable electrode made of natural polymer solid gel with gentle adhesion; LecTec 3000 Series and LecTec 3009 Series, synthetic solid gel electrodes with higher levels of adhesion which meet all American Association for Medical Instrumentation ("AAMI") standards

including defibrillation recovery; and LecTec 4000 Series, a synthetic solid gel, silver substrate electrode which also meets all AAMI standards including defibrillation recovery.

The Company pioneered hydrogel technology and manufactures synthetic and natural-based hydrogels. These hydrogels are resistant to dehydration, evaporation and changes in electrical and physical properties. Hydrogels are also used topically to deliver specific medications to the skin. Hydrogels are manufactured with various levels of conductivity, as well as with varying degrees of self-adhesive properties, for diagnostic electrodes, external defibrillation, pacing and monitoring electrodes, Transcutaneous Electronic Nerve Stimulation ("TENS") products and iontophoretic return electrodes.

Sales of conductive products accounted for approximately 51%, 63% and 61% of the Company's total sales for fiscal years 2000, 1999 and 1998.

MEDICAL TAPE PRODUCTS

The Company adopted a plan at the end of fiscal 2000 to exit the low margin medical tape business for which sales had been declining for several years. The medical tape business was comprised of sales of individual slit roll widths of the standard paper, plastic and cloth products widely used in the health care industry and sales of large jumbo rolls which were converted by the customer into individual slit rolls widths for ultimate sale to consumers. Minimal sales are expected in fiscal 2001 as remaining medical tape inventories are liquidated.

Sales of medical tapes accounted for approximately 13%, 22% and 32% of the Company's total sales for fiscal years 2000, 1999 and 1998.

THERAPEUTIC CONSUMER PRODUCTS

The Company manufactures and markets patches for the topical application of OTC drugs and other therapeutic compounds. Therapeutic patch products use a hydrogel coated, breathable cloth patch to deliver OTC drugs and other therapeutic compounds onto the skin. Products currently manufactured using the adhesive-based patch technology are analgesic patches for localized pain relief, cooling gel comfort patches, vapor cough suppressant patches, anti-itch patches, acne treatment patches, wart removers, and a corn and callus remover. These products are marketed as OTC products. The analgesic, cooling and anti-itch patches are marketed under the LecTec brand name TheraPatch(R). The acne treatment patches, wart removers and corn and callus removers are marketed by the customer under the brand of the customer. The vapor cough suppressant patches are marketed under the TheraPatch brand name as well as by the customer under the brand of the customer.

Sales of therapeutic consumer products accounted for approximately 36%, 15% and 7% of the Company's total sales for fiscal years 2000, 1999 and 1998.

MARKETING AND MARKETING STRATEGY

The Company markets and sells its products to medical products distributors, consumers through retail outlets (food, chain drug and mass merchandise stores), consumer products companies and original equipment manufacturers.

A major entry into the consumer products markets was supported by the hiring of a new retail sales executive late in fiscal 1998 and a retail sales

team in fiscal 1999. In the consumer products markets, retail broker and manufacturer's representative contracts have been established. The TheraPatch brand is the umbrella brand for the Company's therapeutic patch products introduced to all markets.

In addition to the retail sales team hired for entry into the retail consumer products markets, the Company has sales teams which address other markets into which it sells. These teams support sales to:

- medical products distributors who sell to end-user organizations,
- consumer products companies who sell directly to the consumer, and
- OEMs which either include the Company's product with the product they sell (e.g., electrodes purchased from the Company may be included with electrocardiogram machines manufactured and sold by an OEM), or use the Company's jumbo rolls of hydrogels to

manufacture a finished product for sale to the end-user (e.g., hydrogel purchased from the Company may be used by an OEM to make electrodes).

The Company has not experienced any significant seasonality in sales of its products.

The Company sells its products in the U.S., Europe, Latin America, Asia, Canada and Middle East. Except for sales of the TheraPatch brand patch product into Canada, all of the Company's international sales are denominated in U.S. dollars, thus, most of the impact of the foreign currency transaction gains and losses are borne by the Company's customers. The Company does not believe the January 1, 1999 euro currency conversion has had, nor will have, a material impact on its financial statements. Export sales accounted for approximately 13%, 13% and 26% of total sales for 2000, 1999 and 1998.

The Company's international sales are made by the Company's corporate sales force. The Company does not maintain a separate international marketing staff or operations. The following table sets forth export sales by geographic area:

	Years ended June 30		
	2000	1999	1998
Europe	$1,006,412	$1,216,199	$1,705,996
Latin America	547,904	371,654	371,854
Asia	46,279	31,935	62,027
Canada	298,884	7,011	199,082
Middle East	10,272	--	912,240
Other	25,962	28,333	71,949
Total Export Sales	$1,935,713	$1,655,132	$3,323,148

CUSTOMERS

Spacelabs Burdick Inc. accounted for 17%, 22% and 18% of the Company's total sales for the fiscal years 2000, 1999 and 1998. The Company sold its products to approximately 275, 240 and 190 active customers (excluding TheraPatch sales to individuals) during 2000, 1999 and 1998. The Company's backlog orders (purchase orders received from customers for future shipment) as of August 11, 2000 totaled $3,170,000 (all of which the Company expects to fill in fiscal 2001), compared with approximately $913,000 on August 12, 1999. The increase in the backlog as of August 11, 2000 was primarily the result of supply agreements for patch products signed with Johnson & Johnson Consumer Products Company and Novartis Consumer Health, Inc. towards the end of fiscal 2000.

COMPETITION

The markets for electrodes, hydrogels and topical OTC drug delivery patches are highly competitive. Firms in the medical and consumer industries compete on the basis of product performance, pricing, distribution and service. Many of the Company's major competitors have significantly greater financial, marketing and technological resources than the Company. However, the Company believes that it competes on the basis of proprietary technology, speed-to-market, flexibility, innovative "first-in-category" patches, customer focus and its ability to manufacture and market its products to targeted market segments.

Over the past several years there have been a number of mergers within the electrode and hydrogel industries, resulting in fewer but larger competitors.

The Company's primary competitor for electrode and hydrogel sales is Tyco International. The Company's OTC TheraPatch family of analgesic, anti-itch and cough suppressant patches competes with ointments, lotions and creams manufactured by various competitors including Mentholatum/Rohto Pharmaceuticals, Inc.

MANUFACTURING

The Company manufactures its conductive and therapeutic membranes at

the Company's Minnetonka, Minnesota facility. The Minnetonka facility also processes raw materials and manufactures the Company's therapeutic products. The Company's second manufacturing facility in Edina, Minnesota is the primary site for the manufacturing and packaging of diagnostic electrodes and the packaging of therapeutic products. The Edina location also provides the majority of the Company's warehouse capacity.

The Company believes that the raw materials used in manufacturing its products are generally available from multiple suppliers.

RESEARCH AND DEVELOPMENT

The Company's research and development staff consists of professionals drawn from the business and academic communities with experience in the biological, chemical, pharmaceutical and engineering sciences. The research and development staff is responsible for the investigation, development and implementation of new and improved products and new technologies.

The Company may develop products internally, jointly with corporations and/or with inventors from outside the Company. The Company may then market resulting products by sponsoring partners or through a marketing arrangement with an appropriate distributor. Research and development contract opportunities are evaluated on an individual basis.

The Company, through its research and development efforts, is investigating new products for topical delivery of OTC drugs and new conductive adhesive hydrogel polymers. In addition, existing technologies are being refined to focus on new products targeting new customers and new markets.

During fiscal 2000 the Company discontinued development of a cotinine-based smoking cessation product after unsuccessful efforts to secure the third party funding necessary for the next phases of research and development.

During fiscal years 2000, 1999 and 1998, the Company spent approximately $1,095,000, $1,170,000 and $1,037,000 on research and development.

GOVERNMENTAL AND ENVIRONMENTAL REGULATION

The Company's Quality System includes design development planning, testing, manufacturing, packaging, labeling and distribution of the Company's products which are subject to federal and foreign regulations, and in some instances, state and local government regulations.

UNITED STATES REGULATION

The Company's electrodes sold in the United States are subject to federal Food and Drug Administration (the "FDA") policy and are marketed pursuant to Section 510(k) notification, which is a means of obtaining FDA clearance to market a medical device. The Company's finished goods electrodes sold in the United States are subject to the FDA's current Good Manufacturing Practices ("GMP") and quality system regulations.

The Company's hydrogels sold domestically are also subject to GMP and quality system regulations as they are sold to OEMs and distributors for processing into finished commercial goods.

The Company's topical OTC drug delivery patches are marketed under applicable federal FDA OTC monographs.

FOREIGN REGULATION

The Company's electrodes sold into the European Community (the "EC") are considered to be Class I, non-sterile and non-measuring medical devices. These products are "CE" marked and "self declared" as being compliant to the Medical Device Directive 93/42/EEC. An authorized representative for

the Company has been established in the EC as required by European law. Foreign sales of the Company's electrodes are made only into the EC.

There are no foreign regulatory approvals required to sell the Company's hydrogels into foreign countries because these products are sold to OEM customers for processing into finished commercial goods.

The Company's topical OTC drug delivery patches are marketed in Canada under applicable Canadian OTC monographs where appropriate, and are reviewed and approved prior to commercialization by the Health Protection branch of Health Canada.

ENVIRONMENTAL REGULATION

The Company does not use solvents that have an adverse effect on the environment in the manufacturing of its products. The Company does not anticipate any major expenditure for environmental controls during the next fiscal year.

PATENTS AND TRADEMARKS

The Company has U.S. and foreign patents on adhesive hydrogels, electrodes and transdermal and topical delivery systems. Twenty-two active U.S. patents and fourteen active international patents are currently assigned or licensed to the Company. Four U.S. patents were allowed during fiscal 2000 and are expected to be issued to the Company in fiscal 2001. Sixteen U.S. and foreign applications are pending including two which are on appeal. Foreign patent applications are pending in numerous European countries, Canada and Japan. The patents most pertinent to the Company's major products have a remaining duration ranging from four to twenty years. Three of these patents have a remaining duration of less than five years and the expiration of these patents is not expected to have a material effect on the Company's proprietary position.

Four trademark registrations were received in fiscal 2000. One trademark registration is pending.

The Company expects that its products will be subject to continuous modifications due to improvements in materials and technological advances for medical products. Therefore, the Company's continued success does not depend solely upon ownership of patents, but upon technical expertise, creative skills and the ability to forge these talents into the timely release of new products.

The Company uses both patents and trade secrets to protect its proprietary property and information. In addition, the Company monitors competitive products and patent publications to be aware of potential infringement of its rights.

EMPLOYEES

As of June 30, 2000, the Company employed 97 full-time employees. None of the Company's employees are represented by labor unions or other collective bargaining units. The Company believes relations with its employees are good.

EXECUTIVE OFFICERS OF THE REGISTRANT

Name	Age	Title
Rodney A. Young	45	Chairman, Chief Executive Officer and President
Douglas J. Nesbit	48	Chief Financial Officer
Timothy P. Fitzgerald	60	Vice President, Operations
John D. LeGray	54	Vice President, Quality Assurance and Regulatory Affairs
Daniel M. McWhorter	60	Vice President, Research and Development
Jane M. Nichols	54	Vice President, Marketing and New Business Development
Timothy R. J. Quinn	39	Vice President, Consumer Products

Rodney A. Young is Chairman, Chief Executive Officer and President. He joined the Company in August 1996. Prior to joining LecTec, Mr. Young had 23 years of health care industry experience including sales and marketing for Upjohn Company and 3M Company. Prior to joining the Company, he was Vice President and General Manager of the Specialized Distribution Division of Baxter International, Inc.

Douglas J. Nesbit is Chief Financial Officer. He joined the Company in August 2000. Mr. Nesbit's 23-year professional background includes public accounting experience with the big five firm of KPMG LLP. Prior to joining LecTec he was the Chief Financial Officer at Total Solutions Group, Inc. and Treasurer at Secure Computing Corporation.

Timothy P. Fitzgerald is Vice President, Operations. He joined the Company in February 2000. Mr. Fitzgerald's 40-year career includes technical and senior management positions at Bell & Howell Co., International Data Engineering, Inc. and Varitronic Systems, Inc.

John D. LeGray is Vice President, Quality Assurance and Regulatory Affairs. He joined the Company in September 1997. Mr. LeGray's 33-year career includes technical and management positions at DiaSorin Inc., Bayer Corporation and Abbott Laboratories.

Daniel M. McWhorter is Vice President, Research and Development. He joined the Company in January 1997. Mr. McWhorter has more than 28 years of experience in the medical products industry including both technical and general management positions at The Kendall Company and Pharmacia Deltec and senior technical positions at Abbott Laboratories and Mentor Corporation.

Jane M. Nichols is Vice President, Marketing and New Business Development. She joined the Company in April 1997. Ms. Nichols' 28-year career includes clinical, technical and management roles at Methodist Hospital and Park Nicollet Medical Centers, and senior marketing positions at 3M Company and Ecolab.

Timothy R. J. Quinn is Vice President and General Manager, Consumer Products. He joined the Company in May 1998. He has 20 years of sales and marketing experience in the consumer products industry. Prior to joining LecTec, he was Vice President of Sales at Redmond Products. Prior to Redmond, Quinn served in a variety of sales and marketing management positions for Lederle Laboratories and General Foods Corporation. He received his Bachelor of Science Degree in business administration from Western Michigan University and completed Columbia University executive management courses.

ITEM 2. PROPERTIES

The Company owns a building located in Minnetonka, Minnesota, containing 18,000 square feet of office and laboratory space and 12,000 square feet of manufacturing and warehouse space. In addition, the Company leases a building in Edina, Minnesota containing 29,000 square feet of manufacturing and warehouse space. The Edina building lease term extends through June 30, 2002.

ITEM 3. LEGAL PROCEEDINGS

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock trades on the Nasdaq National Market tier of the Nasdaq Stock Market ("Nasdaq") under the symbol LECT.

The following table sets forth the high and low daily trade price information for the Company's common stock for each quarter of fiscal 2000 and 1999. Such prices reflect interdealer prices, without retail mark-up, mark-down, or commission, and may not necessarily represent actual transactions.

YEARS ENDED JUNE 30,	2000		1999	
	HIGH	LOW	HIGH	LOW
First Quarter	$4.375	$2.688	$4.000	$2.250
Second Quarter	3.125	1.188	4.000	2.125
Third Quarter	5.000	1.375	3.000	1.250
Fourth Quarter	4.875	2.000	4.750	1.813

As of September 20, 2000 the Company had 3,904,465 shares of common stock outstanding, and 315 common shareholders of record which number does not include beneficial owners whose shares were held of record by nominees or broker dealers.

The Company has not declared or paid cash dividends on its common stock since its inception, and intends to retain all earnings for use in its business for the foreseeable future.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

CONSOLIDATED STATEMENT OF OPERATIONS DATA

<TABLE>
<CAPTION>

Years ended June 30,	2000	1999	1998	1997	1996
<S>	<C>	<C>	<C>	<C>	<C>
Net sales	$ 14,596,346	$ 12,279,075	$ 12,922,365	$ 12,256,327	$ 13,100,754
Gross profit	5,121,217*	4,093,561	3,715,032	4,324,180	4,969,659
Loss from operations	(2,890,497)**	(1,771,324)	(474,935)	(2,215,951)***	(724,074)
Loss before equity in losses of unconsolidated subsidiary	(2,859,276)**	(1,683,257)	(404,061)	(2,140,660)***	(632,193)
Equity in losses of unconsolidated subsidiary	--	--	--	126,067	--
Net loss	(2,859,276)**	(1,683,257)	(404,061)	(2,266,727)***	(632,193)
Net loss per common and common equivalent share (BASIC AND DILUTED)	(.74)**	(.43)	(.10)	(.59)***	(.17)

</TABLE>

CONSOLIDATED BALANCE SHEET DATA

<TABLE>
<CAPTION>

At June 30,	2000	1999	1998	1997	1996
<S>	<C>	<C>	<C>	<C>	<C>
Cash, cash equivalents and short-term investments	$ 100,171	$ 1,022,025	$ 2,186,532	$ 1,242,777	$ 800,693
Current assets	5,236,110	5,904,111	6,728,531	6,873,696	5,624,682
Working capital	1,512,561	3,497,926	5,335,861	4,035,084	4,240,024
Property, plant and equipment, net	3,039,088	4,028,491	4,306,568	4,592,304	5,112,975
Long-term investments	--	--	8,676	8,013	574,806
Total assets	8,474,549	10,132,573	11,317,774	11,837,356	12,494,003
Long-term liabilities	31,184	217,868	222,000	211,000	174,000
Shareholders' equity	4,719,816	7,508,520	9,703,104	8,787,744	10,935,345

</TABLE>

* Includes a charge of $85,000 related to the plan to exit the medical tape product line.

** Includes a charge of $730,000 or $.19 per share related to the plan to exit the medical tape product line.

*** Includes a nonrecurring restructuring charge of $2,180,353 or $.57 per share.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS RESULTS OF OPERATIONS

NET SALES

Net sales were $14,596,346 in 2000, an increase of 18.9% from net sales of $12,279,075 in 1999. Net sales were $12,922,365 in 1998. The increase in 2000 net sales was primarily the result of increased therapeutic consumer product sales, partially offset by decreased medical tape and conductive product sales. The decrease in 1999 net sales was primarily the result of decreased medical tape sales, partially offset by increased therapeutic consumer product sales.

Net sales of conductive products (medical electrodes and conductive hydrogels) decreased by 4.0% in 2000 to $7,450,755 from $7,758,286 in 1999. Conductive product net sales were $7,906,676 in 1998. These fluctuations in sales were primarily volume-related. The Company expects fiscal 2001 conductive sales to be comparable to fiscal 2000 sales.

Net sales of medical tapes decreased by 29.0% in 2000 to $1,927,392 from $2,716,540 in 1999. Medical tape net sales were $4,157,199 in 1998. The decrease in 2000 was primarily the result of reduced sales to a low-margin slit roll tape customer and decreases in sales volume to several other low-margin medical tape customers. The decrease in 1999 was primarily the result of the absence of sales in 1999 to an international customer. The Company adopted a plan at the end of fiscal 2000 to exit the medical tape business and expects minimal medical tape sales in 2001 as remaining inventories are liquidated.

Net sales of therapeutic consumer products increased 189.2% in 2000 to $5,218,199 from $1,804,249 in 1999. Net sales of therapeutic consumer products were $858,490 in fiscal 1998. The increase in 2000 was primarily the result of increased TheraPatch(R) product sales, which increased 127.1%, and sales in 2000 of the new acne product to Johnson & Johnson Consumer Products Worldwide. The increase in 1999 was primarily the result of increased TheraPatch sales to retailers, both as a result of increased volumes and increased unit selling price. The higher unit selling price in 1999 was the result of the Company selling directly to retailers rather than to CNS, Inc., the Company's exclusive distributor to retailers in the prior year. The agreement under which CNS distributed the TheraPatch product was terminated at the end of fiscal 1998 when the Company assumed responsibility for retail distribution of the product. Management believes that sales of the Company's therapeutic patch products will represent an increased percentage of total net sales during fiscal 2001 due to continued sales growth of the acne product, new sales of Triaminic(R) Vapor brand topical cough and cold patches and increased TheraPatch brand name recognition.

Export sales, consisting primarily of electrodes, semi-finished conductive and medical tape products sold to overseas converters for final processing, packaging and marketing, as well as TheraPatch brand therapeutic consumer products, were 13%, 13% and 26% of total net sales in 2000, 1999 and 1998. All international sales are in U. S. dollars with the exception of TheraPatch brand products sold in Canada. Export sales increased by $280,581 in fiscal 2000 primarily as a result of the Canadian TheraPatch sales. The decrease in the percent for 1999 resulted primarily from the absence in 1999 of medical tape sales to an international customer as well as decreased conductive sales to another customer who began manufacturing product previously purchased from the Company. The Company expects fiscal 2001 international sales will be comparable to 2000.

GROSS PROFIT

The Company's gross profit was $5,121,217 in 2000, up from $4,093,561 in 1999. Gross profit was $3,715,032 in 1998. As a percentage of net sales, gross profit was 35.1% in 2000, 33.3% in 1999 and 28.8% in 1998. Gross profit in 2000 increased by 25.1% from the prior year and gross profit in 1999 increased by 10.2% from the prior year. The increase in gross profit in 2000 resulted primarily from a shift in the sales mix to higher margin therapeutic consumer products. The increase in gross profit in 1999 resulted primarily from a shift in the sales mix to higher margin therapeutic consumer products from lower margin medical tape products, as well as higher margins on therapeutic patch sales primarily as a result of sales made directly to retailers rather than to a distributor.

SALES AND MARKETING EXPENSES

Sales and marketing expenses totaled $3,672,908 or 25.2% of net sales in 2000, compared to $2,187,710 or 17.8% of net sales in 1999, and $1,042,788 or 8.1% of net sales in 1998. The 2000 increase was primarily due to increased TheraPatch related advertising and promotional expenses and slotting fees. The increase in advertising was primarily the result of a TV ad campaign for TheraPatch Vapor for Kids. The increased slotting fees resulted from the placement of TheraPatch products in new stores as well as the placement of new TheraPatch products on the shelves in existing stores. The 1999 increase was primarily due to increased sales staff and advertising and slotting fees to establish new retail accounts. The Company anticipates sales and marketing expenses as a percent of sales in fiscal 2001 will be comparable to 2000.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses totaled $2,598,998 or 17.8% of net sales in 2000, compared to $2,507,432 or 20.4% of net sales in 1999, and $2,110,084 or 16.3% of net sales in 1998. The increase in 2000 was primarily the result of increased consulting expense which more than offset a decrease in legal expenses. Legal expense in the prior year included approximately $126,000 related to the re-negotiation and modification of the license agreement for the

development and commercialization of cotinine as well as legal expenses associated with work on new and existing patents. The increase in 1999 was primarily the result of increased regulatory and quality assurance expenses associated with achieving and maintaining ISO 9001 and EN 46001 certification, expenses related to the re-negotiation and modification of the license agreement for the development and commercialization of cotinine, and legal expenses associated with work on new and existing patents. The Company anticipates general and administrative expenses in fiscal 2001 will be comparable to fiscal 2000.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses totaled $1,094,808 or 7.5% of net sales in 2000, compared to $1,169,743 or 9.5% of net sales in 1999, and $1,037,095 or 8.0% of net sales in 1998. The decrease in 2000 primarily reflects decreased test-run production costs and supplies which were partially offset by increased labor costs. The increase in 1999 reflects increased staffing levels and increased costs for testing of products under development. Management believes that research and development expenditures as a percent of sales will be comparable in fiscal 2001 to fiscal 2000.

MEDICAL TAPE ASSET IMPAIRMENT AND EXIT PLAN

In June of fiscal 2000, the Company adopted a plan to exit the medical tape business effective June 30, 2000. Adoption of this plan resulted in a charge for $645,000 related to the write-down of the medical tape equipment to its estimated fair market value, net of disposal costs, of $526,000. The Company also recorded a charge of $85,000 to reduce the carrying value of medical tape inventory to a net realizable value. The $85,000 charge was included in the cost of goods sold. The Company expects to sell the assets and dispose of the remaining inventory by December 31, 2000.

OTHER INCOME AND EXPENSE

Interest expense increased to $35,405 in 2000 from $1,173 in 1999 primarily due to interest expense associated with the line of credit. There was no interest expense in 1998. Other income decreased to $27,692 in 2000 from $89,240 in 1999 and $69,874 in 1998 primarily due to decreased interest income as a result of lower cash and cash equivalent balances.

INCOME TAX BENEFIT

The Company recorded an income tax benefit in 2000 of $38,934, no income tax expense or benefit in 1999 and an income tax benefit of $1,000 in 1998. The income tax benefit in 2000 resulted primarily from the refund of taxes previously paid by the Company's foreign sales corporation. The foreign sales corporation was dissolved during fiscal 2000. There was no income tax benefit recorded during 2000, 1999 and 1998 related to the loss before income taxes since the tax benefit may not be realizable by the Company.

OPERATIONS SUMMARY

The net loss for 2000 resulted primarily from increased sales and marketing expenses and charges related to the plan to exit the medical tape business which more than offset an increase in gross profit. The increase in gross profit resulted from increased sales volume and a shift in the sales mix toward higher-margin therapeutic consumer products. The net loss for 1999 resulted primarily from increased sales and marketing expenses related to the Company's investment in the consumer products market and increased general and administrative expenses, primarily those expenses related to the modification of the cotinine license agreement and achievement of ISO 9001 and EN 46001 certification. The net loss for 1998 resulted primarily from a decrease in the gross profit percent due to a shift in the sales mix from higher margin conductive and therapeutic consumer products to lower margin medical tape products and increased material costs and material usage.

EFFECT OF INFLATION

Inflation has not had a significant impact on the Company's operations or cash flow.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents decreased by $921,854 to $100,171 at June 30, 2000 from $1,022,025 at June 30, 1999. This decrease was primarily due to the net loss for fiscal 2000 of $2,859,276. Accounts receivable increased by $294,165 to $2,645,710 primarily due to increased sales for June 2000 as compared to June 1999. Inventories increased by $251,162 to $2,247,686 primarily due to increased raw material and finished goods inventory related to therapeutic products which was partially offset by decreased finished goods inventory of medical tape.

Working capital totaled $1,512,561 at June 30, 2000, compared to $3,497,926 at the end of fiscal 1999. The Company's current ratio was 1.4 at June 30, 2000 compared to 2.5 at June 30, 1999.

Capital spending for plant improvements and equipment totaled $425,856 in 2000. There were no material commitments for capital expenditures at June 30, 2000. Net property, plant and equipment decreased by $989,403 to $3,039,088 at June 30, 2000 from $4,028,491 at June 30, 1999, reflecting the write-down of the medical tape equipment to its estimated fair market value of $526,000 and the excess of depreciation expense over capital spending.

Accounts payable increased by $265,643 to $1,910,551 at June 30, 2000 from $1,644,908 at June 30, 1999 primarily due to increased payables related to increased manufacturing production as well as an increase in the average number of days outstanding before payment.

The Company finalized a $2,000,000 asset-based line of credit in November, 1999 and borrowings outstanding on the line were $837,542 at June 30, 2000. The Company was in default at June 30, 2000 with covenants relating to the minimum book net worth and the maximum loss before taxes as a result of the charges totaling $730,000 related to the exit of the medical tape business. These defaults were waived by the bank in an amendment to the line of credit

dated September 26, 2000. Shareholders' equity decreased by $2,788,704 to $4,719,816 as of June 30, 2000 from $7,508,520 as of June 30, 1999, primarily due to the net loss incurred during 2000.

Management believes that existing cash and cash equivalents, internally-generated cash flow, the existing secured line of credit, an expected increase in the existing line of credit due to the addition of international receivables and inventory in the asset base, and expected additional fixed asset-based financing will be sufficient to support anticipated operating and capital spending requirements during fiscal 2001. Management is also evaluating additional sources of capital that may be appropriate for funding longer-term growth and expansion of the business. Maintaining adequate levels of working capital depends in part upon the success of the Company's products in the marketplace, the relative profitability of those products and the Company's ability to control operating expenses. Funding of the Company's operations in future periods may require additional investments in the Company in the form of equity or debt. There can be no assurance that the Company will achieve desired levels of sales or profitability, or that future capital infusions will be available.

FORWARD-LOOKING STATEMENTS

From time to time, in reports filed with the Securities and Exchange Commission (including this Form 10-K), in press releases, and in other communications to shareholders or the investment community, the Company may provide forward-looking statements concerning possible or anticipated future results of operations or business developments which are typically preceded by the words "believes", "expects", "anticipates", "intends", "will", "may", "should" or similar expressions. Such forward-looking statements are subject to risks and uncertainties which could cause results or developments to differ materially from those indicated in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the buying patterns of major customers; competitive forces including new products or pricing pressures; costs associated with and acceptance of the Company's TheraPatch brand strategy; impact of interruptions to production; dependence on key personnel; need for regulatory approvals; changes in governmental regulatory requirements or accounting pronouncements; and ability to satisfy funding requirements for operating needs, expansion or capital expenditures.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has no history of, and does not anticipate in the future, investing in derivative financial instruments, derivative commodity instruments or other such financial instruments. Transactions with international customers are entered into in U. S. dollars with the exception of TheraPatch sales to Canadian customers, precluding the need for foreign currency hedges. These Canadian sales have not been material. Additionally, the Company invests in money market funds and short-term commercial paper, which experience minimal volatility. Thus, the exposure to market risk is not material.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

LecTec Corporation and Subsidiaries Financial Statements Furnished Pursuant to the Requirements of Form 10-K.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Shareholders and
Board of Directors
LecTec Corporation

We have audited the accompanying consolidated balance sheets of LecTec Corporation and subsidiaries as of June 30, 2000 and 1999, and the related consolidated statements of operations, comprehensive loss, shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of LecTec Corporation and subsidiaries as of June 30, 2000 and 1999, and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended June 30, 2000, in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II of LecTec Corporation and subsidiaries for each of the three years in the period ended June 30, 2000. In our opinion, this Schedule presents fairly, in all material respects, the information

required to be set forth therein.

/s/ GRANT THORNTON LLP

Minneapolis, Minnesota
August 18, 2000 (except for note B, as to which the date is September 26, 2000)

LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

<TABLE>
<CAPTION>

ASSETS	*June 30, 2000*	*1999*
<S>	*<C>*	*<C>*
CURRENT ASSETS		
Cash and cash equivalents	*$ 100,171*	*$ 1,022,025*
Receivables		
Trade, net of allowance of $127,100 and $101,800 at June 30, 2000 and 1999	*2,642,880*	*2,335,314*
Other	*2,830*	*16,231*
Inventories	*2,247,686*	*1,996,524*
Prepaid expenses and other	*220,514*	*174,674*
Investments	*22,029*	*5,343*
Deferred income taxes	*--*	*354,000*
Total current assets	*5,236,110*	*5,904,111*
PROPERTY, PLANT AND EQUIPMENT - AT COST		
Land	*247,731*	*247,731*
Building and improvements	*1,879,006*	*1,841,742*
Equipment	*5,080,180*	*7,157,016*
Furniture and fixtures	*414,857*	*413,013*
	7,621,774	*9,659,502*
Less accumulated depreciation	*4,582,686*	*5,631,011*
	3,039,088	*4,028,491*
OTHER ASSETS		
Patents and trademarks, less accumulated amortization of $1,293,871 and $1,154,698 at June 30, 2000 and 1999	*199,351*	*199,971*
	$ 8,474,549	*$ 10,132,573*

</TABLE>

The accompanying notes are an integral part of these statements.

LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS - CONTINUED

<TABLE>
<CAPTION>

LIABILITIES AND SHAREHOLDERS' EQUITY	*June 30, 2000*	*1999*
<S>	*<C>*	*<C>*
CURRENT LIABILITIES		
Note payable to bank	*$ 837,542*	*$ --*
Current maturities of long-term obligations	*22,562*	*11,000*
Accounts payable	*1,910,551*	*1,644,908*
Accrued expenses		
Payroll related	*371,405*	*403,075*
Retail support programs	*421,489*	*165,472*
Other	*--*	*181,730*
Customer deposits	*160,000*	*--*
Total current liabilities	*3,723,549*	*2,406,185*
LONG-TERM OBLIGATIONS, less current maturities	*31,184*	*20,868*
DEFERRED INCOME TAXES	*--*	*197,000*
COMMITMENTS AND CONTINGENCIES	*--*	*--*
SHAREHOLDERS' EQUITY		
Common stock, $.01 par value; 15,000,000 shares authorized; 3,904,465 and 3,876,476 shares issued and outstanding at June 30, 2000 and 1999	*39,045*	*38,765*

Additional contributed capital	11,316,260	11,262,654
Accumulated other comprehensive gain (loss)	4,845	(11,841)
Accumulated deficit	(6,640,334)	(3,781,058)
	4,719,816	7,508,520
	$ 8,474,549	$ 10,132,573

</TABLE>

The accompanying notes are an intregral part of these statements.

LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

<TABLE>
<CAPTION>

	Years ended June 30,		
	2000	1999	1998
<S>	<C>	<C>	<C>
Net sales	$ 14,596,346	$ 12,279,075	$ 12,922,365
Cost of goods sold	9,475,129	8,185,514	9,207,333
Gross profit	5,121,217	4,093,561	3,715,032
Operating expenses			
Sales and marketing	3,672,908	2,187,710	1,042,788
General and administrative	2,598,998	2,507,432	2,110,084
Research and development	1,094,808	1,169,743	1,037,095
Medical tape asset impairment	645,000	--	--
	8,011,714	5,864,885	4,189,967
Loss from operations	(2,890,497)	(1,771,324)	(474,935)
Other income (expenses)			
Interest expense	(35,405)	(1,173)	--
Other, net	27,692	89,240	69,874
Loss before income taxes	(2,898,210)	(1,683,257)	(405,061)
Income tax benefit	(38,934)	--	(1,000)
Net loss	$ (2,859,276)	$ (1,683,257)	$ (404,061)
Net loss per share - basic and diluted	$ (0.74)	$ (0.43)	$ (0.10)
Weighted average shares outstanding - basic and diluted	3,885,911	3,906,694	4,005,455

</TABLE>

The accompanying notes are an intregral part of these statements.

LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

<TABLE>
<CAPTION>

	Years ended June 30,		
	2000	1999	1998
<S>	<C>	<C>	<C>
Net loss	$ (2,859,276)	$ (1,683,257)	$ (404,061)
Other comprehensive income (loss)			
Unrealized gains (losses) on securities available-for-sale			
Unrealized holding gains (losses) arising during period	16,686	(3,333)	13,949
Reclassification adjustment for losses included in net loss	--	--	10,915
	16,686	(3,333)	24,864
Comprehensive loss	$ (2,842,590)	$ (1,686,590)	$ (379,197)

	==========	==========	==========	==========	==========	==========

</TABLE>

The accompanying notes are an intregral part of these statements.

LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

YEARS ENDED JUNE 30, 2000, 1999 AND 1998

<TABLE>
<CAPTION>

	Common stock		Additional contributed capital	Accumulated other comprehensive gain (loss)	Accumulated deficit	Total shareholders' equity
	Shares	Amount				
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Balance at July 1, 1997	3,842,800	$ 38,428	$10,476,428	$ (33,372)	$(1,693,740)	$ 8,787,744
Net loss	--	--	--	--	(404,061)	(404,061)
Cost of shares retired	(10,863)	(109)	(40,627)	--	--	(40,736)
Common shares issued upon exercise of options	11,615	116	40,329	--	--	40,445
Unrealized gain on securities available-for-sale	--	--	--	24,864	--	24,864
Common shares issued to acquire minority shares of consolidated subsidiary	221,948	2,220	1,367,191	--	--	1,369,411
Shares repurchased	(29,500)	(295)	(124,268)	--	--	(124,563)
Warrants issued for services	--	--	50,000	--	--	50,000
Balance at June 30, 1998	4,036,000	40,360	11,769,053	(8,508)	(2,097,801)	9,703,104
Net loss	--	--	--	--	(1,683,257)	(1,683,257)
Common shares issued upon exercise of options	1,000	10	2,390	--	--	2,400
Unrealized loss on securities available-for-sale	--	--	--	(3,333)	--	(3,333)
Common shares issued in connection with the employee stock purchase plan	15,126	151	32,855	--	--	33,006
Shares repurchased	(175,650)	(1,756)	(541,644)	--	--	(543,400)
Balance at June 30, 1999	3,876,476	38,765	11,262,654	(11,841)	(3,781,058)	7,508,520
Net loss	--	--	--	--	(2,859,276)	(2,859,276)
Common shares issued upon exercise of options	500	5	1,295	--	--	1,300
Unrealized gain on securities available-for-sale	--	--	--	16,686	--	16,686
Common shares issued in connection with the employee stock purchase plan	27,489	275	52,311	--	--	52,586
Balance at June 30, 2000	3,904,465	$ 39,045	$11,316,260	$ 4,845	$(6,640,334)	$ 4,719,816

</TABLE>

The accompanying notes are an intregral part of these statements.

LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

	Years ended June 30,		
	2000	1999	1998
<S>	<C>	<C>	<C>
Cash flows from operating activities:			
Net loss	$ (2,859,276)	$ (1,683,257)	$ (404,061)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Medical tape asset impairment and inventory write-down	730,000	--	--
Depreciation and amortization	908,024	851,087	844,594
Warrants issued for services	--	--	50,000
Loss on sales of investments	--	--	10,915
Deferred income taxes	157,000	--	(2,000)

Changes in operating assets and liabilities, net of effect of medical tape asset charges:			
Trade and other receivables	*(294,165)*	*(61,620)*	*(80,617)*
Refundable income taxes	*--*	*52,000*	*341,719*
Inventories	*(336,162)*	*(278,513)*	*859,010*
Prepaid expenses and other	*(45,840)*	*(71,611)*	*(18,192)*
Accounts payable	*265,643*	*835,761*	*29,448*
Accrued expenses	*42,917*	*167,154*	*(104,279)*
Customer deposits	*160,000*	*--*	*--*
Net cash provided by (used in) operating activities	*(1,271,859)*	*(188,999)*	*1,526,537*
Cash flows from investing activities:			
Purchase of property, plant and equipment	*(424,448)*	*(419,469)*	*(406,515)*
Investment in patents and trademarks	*(138,553)*	*(79,513)*	*(62,999)*
Sale of investments	*--*	*--*	*590,873*
Net cash provided by (used in) investing activities	*(563,001)*	*(498,982)*	*121,359*
Cash flows from financing activities:			
Issuance of common stock	*53,586*	*35,006*	*38,745*
Repurchases and retirement of common stock	*--*	*(543,400)*	*(165,299)*
Net borrowings on note payable	*837,542*	*--*	*--*
Proceeds from long-term obligations	*33,649*	*36,849*	*--*
Repayment of long-term obligations	*(11,771)*	*(4,981)*	*--*
Net cash provided by (used in) financing activities	*913,006*	*(476,526)*	*(126,554)*
Net increase (decrease) in cash and cash equivalents	*(921,854)*	*(1,164,507)*	*1,521,342*
Cash and cash equivalents at beginning of year	*1,022,025*	*2,186,532*	*665,190*
Cash and cash equivalents at end of year	*$ 100,171*	*$ 1,022,025*	*$ 2,186,532*

</TABLE>

The accompanying notes are an intregral part of these statements.

LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

<TABLE>
<CAPTION>

	Years ended June 30,		
	2000	*1999*	*1998*
<S>	*<C>*	*<C>*	*<C>*
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	*$ 28,085*	*$ 792*	*$ 1,106*
Cash paid during the year for income taxes	*$ --*	*$ 22,010*	*$ 16,732*

</TABLE>

Supplemental disclosure of non-cash investing and financing activities:

During fiscal 1998, the Company issued 221,948 shares of common stock in exchange for the minority interest in Pharmadyne, valued at $1,369,411.

The accompanying notes are an intregral part of these statements.

LECTEC CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2000, 1999 AND 1998

NOTE A - SUMMARY OF ACCOUNTING POLICIES

LecTec Corporation (the "Company") is primarily engaged in the research, design, manufacture and sale of diagnostic electrodes, conductive hydrogels, medical tapes and therapeutic consumer products. The Company's customers are located throughout the United States as well as Europe, Latin America, Asia, Canada and the Middle East. A summary of the Company's significant accounting policies consistently applied in the preparation of the accompanying financial statements follows:

Basis of Financial Statement Presentation

The consolidated financial statements include the accounts of LecTec Corporation ("LecTec") and subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

The Company considers all highly liquid temporary investments purchased with original maturities of three months or less to be cash equivalents. At times cash and cash equivalents may be in excess of FDIC insurance limits.

Accounts Receivable

The Company grants credit to customers in the normal course of business, but generally does not require collateral or any other security to support amounts due. Management performs on-going credit evaluation of customers. The Company maintains allowances for potential credit losses which, when realized, have been within management expectations.

Investments

The Company's investments are classified as available-for-sale and are reported at fair value. The Company utilizes the specific identification method in computing realized gains and losses.

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market and consist of the following:

	June 30	
	2000	1999
Raw materials	$1,666,544	$1,324,973
Work in process	23,202	69,324
Finished goods	557,940	602,227
	$2,247,686	$1,996,524

Depreciation and Amortization

Depreciation is provided in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives. The straight-line method of depreciation is followed for financial reporting purposes, and accelerated methods are used for tax purposes. Estimated useful lives used in the calculation of depreciation for financial statement purposes are:

Buildings and improvements	5 - 40 years
Equipment	4 - 15 years
Furniture and fixtures	5 - 7 years

The investment in patents and trademarks consists primarily of the cost of applying for patents and trademarks. Patents and trademarks are amortized on a straight-line basis over the estimated useful life of the asset, generally five years.

Revenue Recognition

Revenue is recognized at the time of shipment.

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

Advertising

The Company expenses the cost of advertising as incurred, except for the costs of television commercials. These costs are expensed as the commercials are broadcast. Advertising expense totaled approximately $536,000, $271,000, and $145,000 for the years ended June 30, 2000, 1999 and 1998.

Research and Development

Research and development costs are expensed as incurred and are reported as a

component of selling, general and administrative expenses.

Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding. Diluted net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding and common share equivalents related to stock options and warrants when dilutive.

Common stock options and warrants to purchase 1,048,205, 897,506 and 795,997 shares of common stock with a weighted average exercise price of $6.07, $7.54 and $8.09 were outstanding during the years ended June 30, 2000, 1999 and 1998, but were excluded because they were antidilutive.

Stock Based Compensation

The Company utilizes the intrinsic value method of accounting for its stock-based employee compensation plan. Pro-forma information related to fair value based method of accounting is disclosed in Note F.

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

Fair Value of Financial Instruments

Due to their short-term nature, the carrying value of current financial assets and liabilities approximates their fair values. The fair value of long-term obligations, if recalculated based on current interest rates, would not significantly differ from the recorded amounts.

Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to the 1999 and 1998 balances to conform to the presentation used in 2000.

NOTE B - NOTE PAYABLE TO BANK

The Company entered into a secured line of credit on November 22, 1999, with a maximum borrowing of $2,000,000 as defined in the agreement. The credit agreement expires November 22, 2001 and includes interest computed at the prime rate plus 3% (effective rate of 12.5% at June 30, 2000). The agreement includes a minimum annual interest charge for each year of the agreement ($80,000 and $95,000 for each of the two years ended November 22, 2001). Borrowings outstanding on the line of credit were $837,542 at June 30, 2000. Borrowings under the credit agreement are collateralized by substantially all of the Company's assets. At June 30, 2000, the Company was in violation of certain covenants contained in the credit agreement. These covenant violations were waived by the bank on September 26, 2000 in connection with the establishment of revised financial covenants under the credit agreement. The Company expects to be in compliance with the revised covenants during fiscal 2001.

NOTE C - LONG-TERM OBLIGATIONS

Long-term obligations consists of capital leases, due in various monthly installments up to $1,230 including interest from 10.50% to 15.99% through May 2003, collateralized by equipment.

Maturities of long-term obligations are as follows:

Years ending June 30:

2001	$22,562
2002	19,499
2003	11,685
	$53,746

NOTE D – COMMITMENTS AND CONTINGENCIES

Leases

The Company conducts portions of its operations in a leased facility. The lease provides for payment of a portion of taxes and other operating expenses by the Company. Total rent expense for operating leases was $260,481, $250,641 and $248,931 for the years ended June 30, 2000, 1999 and 1998.

Future minimum lease commitments under all operating leases are as follows:

Years ending June 30:	
2001	$261,700
2002	256,100

NOTE D – COMMITMENTS AND CONTINGENCIES – Continued

Employee Benefit Plan

The Company maintains a contributory 401(k) profit sharing benefit plan covering substantially all employees. The Company matches 50% of employee contributions up to 5% of a participant's compensation. The Company's contributions under this plan were $81,474, $71,006 and $54,901 for the years ended June 30, 2000, 1999 and 1998. The Company may also make a discretionary contribution. No discretionary contributions were made for each of the three years ended June 30, 2000.

Legal Proceedings

The Company is subject to various legal proceedings in the normal course of business. Management believes these proceedings will not have a material adverse effect on the Company's financial position or results of operations.

NOTE E – INCOME TAXES

Income tax expense (benefit) consists of the following:

	Years ended June 30,		
	2000	1999	1998
Current	$(195,934)	$ --	$ 1,000
Deferred	157,000	--	(2,000)
	$ (38,934)	$ --	$ (1,000)

NOTE E – INCOME TAXES – Continued

Deferred tax assets and liabilities represent the tax effects of cumulative future deductible or taxable items that have been recognized in the financial statements as follows:

	June 30,	
	2000	1999
Current assets and liabilities:		
Inventories	$ 160,600	$ 199,400
Vacation pay	73,500	67,100
Write-down of long-lived medical tape assets	232,200	--

Other	115,600	40,900
Net current asset	581,900	307,400
Long-term assets and liabilities:		
Net operating loss carryforwards	2,312,000	1,656,500
Tax credit carryforwards	253,600	253,600
Tax depreciation in excess of book depreciation	(225,000)	(273,400)
Charitable contribution carryforwards	19,200	18,900
Other	69,800	57,500
Net long-term asset	2,429,600	1,713,100
Net deferred tax asset	3,011,500	2,020,500
Less valuation allowance	(3,011,500)	(1,863,500)
Net deferred tax asset	$ --	$ 157,000

At June 30, 2000, the Company has available net operating loss carryforwards of approximately $6,800,000 which can be used to reduce future taxable income. The utilization of a portion of these net operating loss carryforwards is restricted under Section 382 of the Internal Revenue Code due to past ownership changes. These net operating loss carryforwards begin to expire in 2007. A valuation allowance has been recorded for these net operating loss carryforwards as they may not be realizable.

NOTE E - INCOME TAXES - Continued

Differences between income tax benefit and the statutory federal income tax rate of 34% are as follows:

	2000	1999	1998
Federal statutory income tax rate	(34.0)%	(34.0)%	(34.0)%
State income taxes, net of federal effect	.1	--	0.3
Foreign sales corporation	--	--	(11.1)
Change in valuation allowance	33.6	34.4	58.0
Tax exempt investment income	--	--	(1.7)
Prior years' overaccruals	--	--	(3.7)
Other	(1.0)	(0.4)	(8.0)
	(1.3)%	-- %	(0.2)%

NOTE F - EQUITY TRANSACTIONS

Employee Stock Purchase Plan

The Company's employee stock purchase plan, adopted November 19, 1998, allows eligible employees to purchase shares of the Company's common stock through payroll deductions. The purchase price is the lower of 85% of the fair market value of the stock on the first or last day of each six-month period during which an employee participated in the plan. The Company has reserved 200,000 shares under the plan. The Company issued 27,489 and 15,126 shares in connection with purchases by employees for $52,586 and $33,006 for the years ended June 30, 2000 and 1999.

NOTE F - EQUITY TRANSACTIONS - Continued

Stock Options and Warrants

The Company has stock option plans for the benefit of selected officers, employees and directors of the Company. A total of 1,673,049 shares of common stock are reserved for issuance under the plans. Options under the Company's

plans are granted at fair market value and expire at five or ten years from the grant date. Options given to directors are exercisable at the date of grant. Options given to selected officers and employees are exercisable at such times as set forth in the individual option agreements, generally vesting 100% after three to four years.

A summary of the Company's stock option transactions for the years ended June 30, 2000, 1999 and 1998 is as follows:

	Number of shares	Weighted average exercise price
Outstanding at July 1, 1997	722,833	$8.46
Granted	219,000	5.31
Exercised	(11,615)	3.35
Canceled	(82,598)	6.37
Outstanding at June 30, 1998	847,620	7.86
Granted	304,200	2.76
Exercised	(1,000)	2.00
Canceled	(16,994)	8.74
Outstanding at June 30, 1999	1,133,826	6.48
Granted	115,000	3.04
Exercised	(500)	2.00
Canceled	(221,704)	8.44
Outstanding at June 30, 2000	1,026,622	$5.68

A total of 604,971, 593,876 and 459,994 options were exercisable at June 30, 2000, 1999 and 1998, with a weighted average price of $6.54, $7.83 and $8.35.

NOTE F - EQUITY TRANSACTIONS - Continued

The following information applies to grants that are outstanding at June 30, 2000:

<TABLE>
<CAPTION>

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
<S>	<C>	<C>	<C>	<C>	<C>
$2.00- $2.99	341,000	3.7 years	$ 2.71	117,750	$ 2.60
$3.00- $4.99	97,571	4.8 years	3.54	46,291	3.55
$5.00- $7.49	273,250	5.7 years	5.66	179,312	5.76
$7.50-$11.24	214,801	4.5 years	8.77	200,988	8.85
$11.25-$13.50	100,000	6.1 years	11.25	60,000	11.25
	1,026,622			604,971	

</TABLE>

The weighted average fair value of the options granted during 2000, 1999 and 1998 were $1.84, $1.47 and $2.77. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions used for all grants in 2000, 1999 and 1998: zero dividend yield, expected volatility of 74%, 62% and 52%, risk-free interest rate of 6.53%, 5.77% and 5.57% and expected lives of 4.00, 4.09 and 5.16 years.

Management believes the Black-Scholes option valuation model currently provides the best estimate of fair value. However, the Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of several subjective assumptions. The Company's employee and director stock options have characteristics different from those of traded options, and changes in the subjective input assumptions can materially affect the fair value estimate. In management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee and director stock options.

NOTE F - EQUITY TRANSACTIONS - Continued

The Company's net loss and net loss per share for 2000, 1999 and 1998 would have been increased to the pro forma amounts indicated below had the fair value method been used for options granted to employees and directors. These effects may not be representative of the future effects of applying this method.

<TABLE>
<CAPTION>

	2000		1999		1998	
	As reported	Pro forma	As reported	Pro forma	As reported	Pro forma
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Net loss	$(2,859,276)	$(3,447,381)	$(1,683,257)	$(2,201,974)	$ (404,061)	$ (897,365)
Net loss per share - basic/diluted	$(.74)	$(.89)	$(.43)	$(.56)	$(.10)	$(.22)

</TABLE>

During 1998, the Company issued a warrant to an outside consultant for the purchase of 12,953 shares of the Company's common stock at $6.25 per share, expiring November 20, 2004, in exchange for recruiting and placement services. The fair value of the warrant granted was calculated on the date of grant using the Black-Scholes option-pricing model.

Stock Repurchase Program

In April 1998, the Company's Board of Directors authorized a stock repurchase program pursuant to which up to 500,000 shares, or approximately 12.4% of the Company's outstanding common stock, may be repurchased. The shares may be purchased from time to time through open market transactions, block purchases, tender offers, or in privately negotiated transactions. The total consideration for all shares repurchased under this program cannot exceed $2,000,000. During the year ended June 30, 1999, the Company repurchased 175,650 shares for $543,400. There were no shares repurchased during the year ended June 30, 2000.

NOTE G - MEDICAL TAPE ASSET IMPAIRMENT AND EXIT PLAN

The Company announced that it was exiting the medical tape business effective June 30, 2000 and recorded a charge of $730,000. The Company analyzed all long-lived medical tape assets in connection with this exit and recorded a reduction of $645,000 to their estimated fair market value of $526,000. The Company also recorded a charge of $85,000 to reduce the current carrying value of medical tape inventory to a net realizable value which has been included with costs of goods sold. The Company expects to sell the assets by December 31, 2000.

NOTE H - PHARMADYNE CORPORATION AND RESTRUCTURING

In October 1997, the Company issued 221,948 new shares of its common stock to acquire the minority interests in Pharmadyne. In November 1997, the newly issued shares were registered with the Securities and Exchange Commission. On December 31, 1997, Pharmadyne Corporation was merged into LecTec Corporation.

NOTE I - SEGMENT INFORMATION

The Company operates its business in one reportable segment - the manufacture and sale of products based on advanced skin interface technologies. Each of the Company's major product lines have similar economic characteristics, technology, manufacturing processes, and regulatory environments. Customers and distribution and marketing strategies vary within major product lines as well as overlap between major product lines. The Company's executive decision makers evaluate sales performance based on the total sales of each major product line and profitability on a total company basis, due to shared infrastructures, to make operating and strategic decisions. Net sales by major product line were as follows:

Years ended June 30,	2000	1999	1998
Conductive products	$ 7,450,755	$ 7,758,286	$ 7,906,676
Medical tape products	1,927,392	2,716,540	4,157,199
Therapeutic consumer products	5,218,199	1,804,249	858,490

$14,596,346	$12,279,075	$12,922,365

NOTE I - SEGMENT INFORMATION - Continued

Export sales accounted for approximately 13%, 13% and 26% of total net sales during the years ended June 30, 2000, 1999, and 1998. Export sales are attributed to geographic region based upon the location of the customer. Export sales by geographic area were as follows:

Years ended June 30,	2000	1999	1998
Europe	$1,006,412	$1,216,199	$1,705,996
Latin America	547,904	371,654	371,854
Asia	46,279	31,935	62,027
Canada	298,884	7,011	199,082
Middle East	10,272	-	912,240
Other	25,962	28,333	71,949
	$1,935,713	$1,655,132	$3,323,148

NOTE J - MAJOR CUSTOMER

One customer accounted for 17%, 22% and 18% of total sales for each of the three years ended June 30, 2000. The accounts receivable from this customer represented 18% and 26% of trade receivables at June 30, 2000 and 1999. Management believes that the loss of this customer could have a material adverse effect on the Company.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required under this item with respect to directors will be included under the heading "Election of Directors" in the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held November 16, 2000, and is incorporated herein by reference. The information required under this item with respect to executive officers is included under the heading "Executive Officers of the Registrant" of Item 1 of this Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

The information required under this item will be included under the heading "Executive Compensation" in the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held November 16, 2000, and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required under this item will be included under the heading "Security Ownership of Certain Beneficial Owners and Management" in the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held November 16, 2000, and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information required under this item with respect to certain relationships and related transactions will be included under the heading "Certain Relationships and Related Transactions" in the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held on November 16, 2000, and is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Financial Statements, Schedules and Exhibits

1. Financial Statements

The following consolidated financial statements of the Company and its subsidiaries are filed as a part of this Form 10-K in Part II, Item 8:

(i) Report of Independent Certified Public Accountants
(ii) Consolidated Balance Sheets at June 30, 2000 and 1999
(iii) Consolidated Statements of Operations for the years ended June 30, 2000, 1999 and 1998
(iv) Consolidated Statements of Comprehensive Loss for the years ended June 30, 2000, 1999 and 1998
(v) Consolidated Statements of Shareholders' Equity for the years ended June 30, 2000, 1999 and 1998
(vi) Consolidated Statements of Cash Flows for the years ended June 30, 2000, 1999 and 1998
(vii) Notes to the Consolidated Financial Statements

2. Financial Statement Schedules

(i) Schedule II - Valuation and Qualifying Accounts, for each of the three years in the period ended June 30, 2000 Page 38

(ii) Other Schedules - All other schedules have been omitted because of the absence of the conditions under which they are required or because the required information is included in the financial statements or the notes thereto.

3. Exhibits

		Method of Filing
3.01	Articles of Incorporation of Registrant, as amended	(1)
3.02	By-laws of Registrant	(1)
10.01	Service Agreement dated July 1, 1986, between LecTec International, Inc., a U.S. Virgin Islands corporation, and LecTec Corporation, relating to the sale, lease or rental of certain property outside the United States.	(1)
10.02	Distribution and Commission Agreement dated July 1, 1986, between LecTec International, Inc., a U.S. Virgin Islands corporation, and LecTec Corporation, relating to the sale, lease or rental of certain property outside the United States.	(1)

10.03	Certificate of Secretary pertaining to Resolution of Board of Directors of LecTec Corporation, dated October 30, 1986, implementing a Profit Sharing Bonus Plan.	(1)
**10.04	LecTec Corporation 1989 Stock Option Plan	(2)
**10.05	LecTec Corporation 1991 Directors' Stock Option Plan	(2)
10.06	Building lease dated May 24, 1991 between LecTec Corporation and Sierra Development Co. for the lease of the manufacturing and warehouse facility located in Edina, Minnesota	(2)
10.07	First amendment dated May 5, 1997 between LecTec Corporation and Rushmore Plaza Partners Limited Partnership for the extension of the previous lease of the manufacturing and warehouse facility located in Edina, Minnesota	(2)
10.08	Articles of Merger of Pharmadyne Corporation into LecTec Corporation dated December 31, 1997, whereby Pharmadyne, a wholly-owned subsidiary, is merged into LecTec Corporation	(3)
**10.09	Change In Control Termination Pay Plan adopted May 27, 1998, for the benefit of certain employees of LecTec Corporation in	

		the event of a Change in Control	(3)
	**10.10	LecTec Corporation Employee Stock Purchase Plan	(4)
	**10.11	LecTec Corporation 1998 Stock Option Plan	(5)
	10.12	LecTec Corporation 1998 Directors' Stock Option Plan	(5)
	10.13	Letter of Intent dated April 19, 1999 between LecTec Corporation and Johnson & Johnson Consumer Companies, Inc., whereby the parties agree to certain milestones leading to the development of a skin care product	(6)
	10.14	Credit and Security Agreement by and between LecTec Corporation and Wells Fargo business Credit, Inc. dated November 22, 1999 and First Amendment To Credit and Security Agreement and Waiver of Defaults dated February 9, 2000, whereby the parties agree to the terms and amended terms regarding a line of credit	(7)
	*10.15	Supply Agreement dated as of May 15, 2000 by and between LecTec Corporation and Novartis Consumer Health, Inc., whereby the parties agree to terms for the sale of product from LecTec Corporation to Novartis Consumer Health, Inc.	(8)

	21.01	Subsidiaries of the Company	(8)
	23.01	Consent of Grant Thornton LLP	(8)
	27.01	Financial Data Schedule	(8)

- - ----------

* Confidential treatment has been requested for portions of this Exhibit pursuant to Rule 24b-2 under the Securities Exchange Act of 1934 as amended. The confidential portions have been deleted and filed separately with the United States Securities and Exchange Commission together with a confidential treatment request.

** Management contract or compensatory plan or arrangment required to be filed as an exhibit to this Form 10-K.

(1) Incorporated herein by reference to the Company's Form S-18 Registration Statement (file number 33-9774C) filed on October 31, 1986 and amended on December 12, 1986.

(2) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 1997.

(3) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 1998.

(4) Incorporated herein by reference to the Company's Registration Statement on Form S-8 (file number 333-72571) filed on February 18, 1999.

(5) Incorporated herein by reference to the Company's Registration Statement on Form S-8 (file number 333-72569) filed on February 18, 1999.

(6) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 1999.

(7) Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 1999.

(8) Filed herewith.

(b) 1. Reports on Form 8-K.

None.

LecTec Corporation and Subsidiaries
Schedule II
Valuation and Qualifying Accounts
Three Years Ended June 30, 2000

<TABLE>

<CAPTION>

Description	Balance at Beginning of Period	Charged to costs and expenses	Charge to other accounts	Deductions (a)	Balance at end of period
<S>	<C>	<C>	<C>	<C>	<C>
Allowance for doubtful accounts					
Year ended June 30, 1998	48,529	48,000	--	5,711	90,818
Year ended June 30, 1999	90,818	48,000	--	37,067	101,751
Year ended June 30, 2000	101,751	48,000	--	22,626	127,125
Allowance for sales returns and credits					
Year ended June 30, 1998	17,598	71,070	--	--	88,668
Year ended June 30, 1999	88,668	61,876	--	93,787	56,757
Year ended June 30, 2000	56,757	345,855	--	160,206	242,406
Allowance for inventory obsolescence					
Year ended June 30, 1998	143,438	300,000	--	233,216	210,222
Year ended June 30, 1999	210,222	243,198	--	168,811	284,609
Year ended June 30, 2000	284,609	267,911	--	406,545	145,975

</TABLE>

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on the 27th day of September, 2000.

LECTEC CORPORATION

/s/Rodney A. Young

Rodney A. Young
Chairman, Chief Executive Officer and President
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

/s/Rodney A. Young — September 27, 2000

Rodney A. Young
Chairman, Chief Executive Officer and President
(Principal Executive Officer)

/s/Douglas J. Nesbit — September 27, 2000

Douglas J. Nesbit
Chief Financial Officer
(Principal Financial Officer and Accounting Officer)

/s/Lee M. Berlin — September 27, 2000

Lee M. Berlin
Director

/s/Bert J. McKasy — September 27, 2000

Bert J. McKasy
Director

/s/Marilyn K. Speedie — September 27, 2000

Marilyn K. Speedie

/s/Donald C. Wegmiller — September 27, 2000

Donald C. Wegmiller
Director

EXHIBIT INDEX

Exhibits
- - --------

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NOTES:

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(7) *Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 1999.*

EXHIBIT 10.15

SUPPLY AGREEMENT

THIS SUPPLY AGREEMENT, dated as of May 15, 2000 (the "Effective Date"), is between Novartis Consumer Health, Inc., 560 Morris Avenue, Summit, New Jersey 07901 ("Novartis"), a Delaware corporation, and LecTec Corporation, a Minnesota corporation, 10701 Red Circle Dr., Minnetonka, MN 55343 ("LecTec").

Background

A. LecTec is a manufacturer of medical and health-related consumer products, including a line of proprietary patch products for the over-the-counter market which emit vapors which, when inhaled, provide relief of cough and cold symptoms (the "Vapor Patches"). LecTec manufactures and sells such patch products under its own trade names and also manufactures and sells certain of such patch products to third parties.

B. Novartis is a manufacturer and reseller of health-related consumer products.

C. Novartis desires to obtain a supply of certain LecTec patch products, and LecTec desires to supply same, all upon the terms and conditions set forth below and in the attached exhibits.

NOW, THEREFORE, the parties do hereby agree to the following:

1. GENERAL SCOPE OF AGREEMENT

1.1 Manufacturing. LecTec has developed and shall manufacture, sell and cause to be delivered to Novartis the products set forth in Exhibit A hereto (the "Products") in quantities sufficient to meet the total requirements, consistent with the forecasting and purchase order mechanism set forth in Article 3 of this Agreement, of Novartis for use in the pediatric field of use (the "Field of Use") and in the countries set forth in Exhibit D hereto (the "Territory") of such Products. LecTec shall manufacture and sell the Products exclusively to Novartis, provided, however, "exclusivity" in the foregoing sentence shall mean that LecTec may not manufacture and sell the Products or any other Vapor Patches (collectively, "Comparable Products") in the Field of Use and in the Territory to any other customer. Notwithstanding such exclusivity, LecTec may continue to manufacture and sell Comparable Products directly to retailers under its "TheraPatch" tradename, or under any Other LecTec Trade Name (as defined below) even if such Comparable Products may compete directly with the Products in the Field of Use and in the Territory. The term "Other LecTec Trade Names" shall mean any LecTec tradenames in existence at the Effective Date or as developed by LecTec during the term of this Agreement, but not including any third party's trade names which LecTec acquires or to which LecTec otherwise gains rights during the term of this Agreement.

*1.2 (*)*

** Denotes confidential information that has been omitted from the exhibit and filed separately, accompanied by a confidential treatment request, with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934.*

*1.2.1 (*)*

*1.2.2 (*)*

1.3 Fulfillment of Requirements. Novartis shall purchase all of Novartis' requirements of the Products for use in the Territory and the Field of Use exclusively from LecTec, in accordance with and subject to the terms and conditions of this Agreement. This requirements obligation is limited to Novartis' requirements of Products which meet the Specifications (as defined below).

1.4 Minimum Requirements. During the period commencing on the Effective Date and ending on December 31, 2001 (the "Initial Period"), and during each calendar year thereafter (the Initial Period and each calendar year thereafter each being a "Period"), Novartis shall purchase at least the minimum requirements of Products set forth in Exhibit C hereto (the "Minimum Requirements").

1.4.1 In calculating whether Novartis has in fact purchased the Minimum Requirements, the parties shall count all variations of the Products purchased by Novartis from LecTec in the Period in one cumulative total. Any Products returned to LecTec by Novartis hereunder shall not be counted in such total (but replacements of such returned Products shall be

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included in such counting as if such replacements had been purchased at the time of the Products being replaced).

1.4.2 Beginning on January 1, 2002 and in each January thereafter, if Novartis failed to purchase at least the Minimum Requirements of Products during the preceding Period, then, by February 28 of the applicable calendar year, Novartis shall either (a) place firm purchase orders for the shortfall ("Shortfall") and such Shortfall amount of Products shall be deemed added, on a one-time basis, to the Minimum Requirements for the Period in which such purchase order is placed; or (b) pay to LecTec an amount equal to forty percent (40%) of the difference between (i) the amount Novartis would have paid if it had actually purchased the Minimum Requirements of Products for such period and (ii) the amount actually paid for Products purchased during such period ("Compensatory Payment"). If Novartis elects not to place such orders for the Shortfall amount by such date, and elects not to make the Compensatory Payment by such date, then LecTec shall no longer be obligated to sell Products to Novartis on an exclusive basis within the Field of Use and the Territory and may thereafter sell Comparable Products to third parties within the Field of Use and the Territory. Upon such termination of Novartis' exclusivity, Novartis shall cease to have any requirements to purchase the Minimum Requirements of the Products. The provisions of this Section 1.4.2 shall not apply in the event that Novartis' failure to purchase the Minimum Requirements is due to to the actions or omissions of LecTec.

1.4.3 On January 1, 2002, at the option of LecTec, the parties shall negotiate in good faith an increase in the annual Minimum Requirements. However, in no event shall Novartis be obligated to agree to an increase in the Minimum Requirements of more than twenty-five percent (25%).

1.5 Regulatory Compliance. As set forth below, LecTec shall be responsible for regulatory compliance in the manufacture of the Products and supply of same to Novartis. Novartis shall be responsible for regulatory compliance in the proper labeling of the Products and the sale of same to end users, directly or indirectly, which shall be under the exclusive control of Novartis. The parties shall cooperate in good faith to achieve such regulatory compliance.

1.6 Production Standards. All Products sold and delivered to Novartis hereunder shall (a) conform in all material respects with the specifications set forth in the Quality Assurance Agreement, attached hereto as Exhibit B (the "QA Agreement"), and with such further specifications as shall be agreed to by all parties in writing (the "Specifications"); (b) be manufactured, packaged and sold to Novartis without any material deviation from or breach of (i) the QAAgreement, and (ii) any applicable laws, regulations, and requirements of any government or governmental agency; and (c) be subject to the warranties set forth in Article 9 of this Agreement.

1.7 Brand Name. Novartis intends to market the Products under the

proprietary names "Vapor Patch" or "VaporPatch" (as selected by Novartis in its own discretion). LecTec hereby acknowledges that it has no objection to Novartis seeking to register such names at its own expense and risk with the United States Trademark Office, or with other authorities, and

shall file its consent thereto, as requested in writing by Novartis, but LecTec does not warrant or imply that such marks are otherwise available or will be granted. LecTec shall give commercially reasonable cooperation to Novartis to manufacture and label the Products with such name or names or other names as Novartis, in its sole discretion, may designate from time to time during the term of this Agreement. However, subject to the foregoing, nothing herein shall be deemed to authorize the use of any LecTec trade name or trademark or any other mark that would dilute or reasonably tend to dilute any such LecTec trade name or trademark.

2. PAYMENT

2.1 Prices. In consideration of the satisfactory manufacture and delivery to Novartis of the ordered quantities of Products, and subject to adjustment in accordance with this Agreement, Novartis shall pay LecTec for the Products in accordance with the prices set forth in Exhibit C hereto. Novartis shall make such payments within thirty (30) days of the date of each LecTec invoice issued upon shipment of the Products. Such payments shall be without prejudice to the inspection and credit rights of Novartis under Article 4 of this Agreement.

2.2 Taxes. Novartis shall bear the cost of taxes of any kind, nature or description whatsoever applicable to the sale of any Products by LecTec to Novartis (other than taxes based upon the income of LecTec or LecTec's employees), unless Novartis is exempt therefrom and provides to LecTec, at the time of the submission of any Purchase Order, tax exemption certificates or permits acceptable to the appropriate taxing authorities.

*2.3 Shipment. (*)*

*2.4 (*)*

*2.5 (*)*

** Denotes confidential information that has been omitted from the exhibit and filed separately, accompanied by a confidential treatment request, with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934.*

*2.5.1 (*)*

*2.5.2 (*)*

*2.5.3 (*)*

*2.6 (*)*

2.7 Raw Material Vendors. Novartis may at any time identify to LecTec lower cost and comparable quality sources from which LecTec may obtain any of the Raw Materials. In such an event, except to the extent that such other source is unable to reasonably satisfy LecTec's quality, service or delivery standards, or any of LecTec's other standard vendor qualification requirements, LecTec shall utilize the sources identified by Novartis as soon as commercially

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Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934.

feasible, and the prices charged to Novartis for Products shall be reduced by the amount of any resulting reductions in Raw Material costs. Novartis shall reimburse LecTec for any costs LecTec shall reasonably incur in implementing any such change in sources.

*2.8 (*)*

*2.9 (*)*

3. FORECASTS AND ORDERS

3.1 Rolling Forecasts. In order to assist LecTec in planning production, Novartis shall provide LecTec with a twelve (12) month rolling forecast of the quantities of Products and delivery dates required by Novartis, by month, for the following twelve (12) months. It is understood that such forecasts are intended to be estimates only and shall not be binding upon Novartis. Notwithstanding the foregoing, Novartis shall be bound to purchase from LecTec one hundred percent (100%) of those quantities of Products set forth in each such forecast as being Novartis' requirements of Products for the first three (3) months of each twelve (12) month period and, accordingly, shall issue purchase orders therefor pursuant to Section 3.2. LecTec shall, no later than ten (10) business days after receipt of each such forecast, notify Novartis in writing of any prospective problems of which it is then aware that might prevent it from meeting Novartis' forecasted order quantities or estimated delivery dates. Unless LecTec so informs Novartis that it would have problems in meeting Novartis' forecasted requirements, LecTec shall be obligated to deliver during any calendar year, pursuant to purchase orders provided under Section 3.2 of this Agreement, up to one hundred twenty percent (120%) of Novartis' estimated purchases for that calendar year (but in no single month more than one hundred fifty percent

** Denotes confidential information that has been omitted from the exhibit and filed separately, accompanied by a confidential treatment request, with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934.*

(150%) of those quantities of Products set forth in the most recent forecast as being Novartis' requirements of Products for the first month of the forecasted twelve (12) month period). LecTec shall further use its commercially reasonable efforts to comply with purchase orders for Products in excess of such one hundred twenty percent (120%) and one hundred fifty percent (150%) amounts.

3.2 Purchase Orders. Subject to Section 3.1, at least sixty (60) days prior to the date on which Novartis desires to have a shipment of Products delivered (as defined in Section 2.4), Novartis shall furnish to LecTec a binding purchase order for such shipment, stating (a) the desired quantity of Products, and (b) the desired delivery date. Each such Novartis purchase order shall be subject to acceptance by LecTec. If LecTec has not indicated in writing its rejection of such a purchase order within five (5) business days from receipt of same, such purchase order shall be deemed accepted. If LecTec cannot accept a specific purchase order, it shall, within such 5-day period, inform Novartis in writing of the circumstances and of LecTec's proposed alternative delivery proposal. In such event, Novartis shall have no firm commitment to purchase, and LecTec shall have no firm commitment to supply, unless Novartis furnishes LecTec with a new purchase order incorporating such alternative proposal and LecTec has accepted same.

3.3 Amendment of Purchase Orders. LecTec shall use its commercially reasonable efforts to accommodate any Novartis requests for delivery of Products

in excess of the quantities described in any previously-submitted and accepted purchase order, or for delivery of Products sooner than that allowed pursuant to this Article 3. If Novartis' business conditions necessitate reduction or delay in purchase order requirements, then LecTec shall use its commercially reasonable efforts to implement such requested changes. Notwithstanding the foregoing, LecTec shall not take any action in response to any such requests which would result in charges to Novartis in addition to those set forth in the respective purchase order without Novartis' prior written consent.

4. INSPECTIONS AND ACCEPTANCE

4.1 Inspection; Right of Rejection. Novartis shall accept any delivery of Products hereunder if, in Novartis' sole and reasonable discretion, Novartis determines that the delivery complies fully with the relevant purchase order, the Specifications and the requirements of this Agreement. Novartis shall have the right to inspect all Products delivered hereunder within thirty (30) days of its receipt of the Products and all required documentation. Novartis shall provide LecTec with written notice of its acceptance or rejection of the shipment within sixty (60) days of receipt of the Products and all required documentation. Any notice of rejection shall specify the reason(s) therefor. Except in the event of any investigation, corrective action or retesting of a shipment, if Novartis fails to provide LecTec with written notice of its acceptance or rejection of the shipment within sixty (60) days of receipt of the Products and all required documentation, then the shipment shall be deemed to have been accepted by Novartis. Novartis' prior payment of any invoice for a shipment which is timely rejected under this Section 4.1 shall not prejudice Novartis' right under Section 4.2 to seek replacement Products or a credit or refund, as Novartis may deem appropriate, with respect to any such rejected Products.

4.2 Replacements. If Novartis notifies LecTec that any, or any part thereof, is rejected pursuant to Section 4.1, then, at Novartis' option, (a) LecTec shall, at no additional charge, deliver replacement Products to Novartis as soon as reasonably practicable thereafter (but, in any event, within ninety (90) days after the initial notification by Novartis); or (b) the purchase order at issue shall be deemed terminated, and Novartis shall not be obligated to make any payments to LecTec with respect to such purchase order or the rejected shipment (or, if payment has already been made for such Products, then Novartis shall be entitled to a credit in such amount). Novartis shall give commercially reasonable cooperation to LecTec to determine the nature and extent of any problem giving rise to a rejection of Products, including, without limitation, prompt samples of any allegedly non-conforming Products.

4.3 Returns. Novartis shall not return any rejected Products to LecTec except upon a return material authorization ("RMA") from LecTec. LecTec shall pay the freight to deliver replacement Products to Novartis for rightfully rejected Products, and LecTec shall pay the freight to return to LecTec or its designee rejected Products for which LecTec has provided to Novartis an RMA.

5. DOCUMENTATION AND INFORMATION

5.1 Confirmation. LecTec shall submit to Novartis the batch manufacturing and testing documents relating to any Products ordered hereunder, within ten (10) days of the completion of the manufacturing process with respect to any particular batch of Products. LecTec shall provide such documentation as reasonably requested by Novartis solely (a) to assist Novartis in determining whether any manufactured or delivered Products comply fully with the Specifications and the requirements of this Agreement; (b) to assist Novartis in obtaining any and all regulatory approvals necessary to market the Products in the Territory; or (c) to enable Novartis to comply with any statutory or regulatory requirements or with a request by any governmental or regulatory authority in the Territory. Such records and reports shall be subject to the confidentiality provisions of Article 8 of this Agreement, shall be deemed LecTec's Confidential Information, and shall be subject to the requirements of Section 1.3 of the QA Agreement.

5.2 Certificate of Analysis. Every shipment of the Products to Novartis shall be accompanied by a Certificate of Analysis from LecTec to certify the active ingredients therein. LecTec shall warrant the accuracy of each such

Certificate of Analysis to a reasonable degree of scientific certainty.

5.3 Books and Records. LecTec shall keep on file all books and records in connection with the manufacture and testing of the Products, including, but not limited to, those books and records relating to cross-over cleaning, process validation, installation qualification, operational qualification and cleaning validation for a period of seven (7) years, plus the active year, from the time of generation of such documents.

6. PRODUCTION PROCEDURES

6.1 No Reworked Products. LecTec shall not rework or reprocess any non-conforming Products without the prior written approval of Novartis.

6.2 Product Packaging. The Products shall be delivered to Novartis packaged in accordance with the Specifications. Notwithstanding the foregoing, Novartis shall have the right to require any special or varied packing that it believes is reasonably necessary to meet customs or regulatory requirements in the Territory. Reasonable incremental costs which result directly from any packing changes required by Novartis will be borne by Novartis.

6.3 Production Procedures. At an agreed upon time prior to its first production run of the Products for Novartis, and at some mutually agreeable time prior to the production of qualification batches, LecTec either shall provide to a designated Novartis employee, or shall permit such designated Novartis employee to review at LecTec's facility, for Novartis' review and approval, LecTec's production procedures for the Products ("Production Procedures"). Such Production Procedures shall include the manufacturing site, manufacturing equipment, manufacturing process, manufacturing conditions and testing procedures for the manufacture of the Products. After such initial Novartis approval, if LecTec wishes to make any material change in any of the Production Procedures so documented and approved, LecTec shall provide notice thereof to the designated Novartis employee, and shall permit such designated Novartis employee to review such proposed changes at LecTec's facility, at least thirty (30) days prior to its first production run under such revised Production Procedures. All such changes to the Production Procedures must be approved in writing by Novartis prior to being implemented, which approval shall not unreasonably be withheld.

6.4 Waste Disposal. LecTec represents and warrants, to the best of its knowledge, and shall take all commercially reasonable actions necessary to ensure, that all facilities, equipment and practices used to perform LecTec's responsibilities under this Agreement by or on behalf of LecTec, or by any of LecTec's contractors of any rank (including, without limitation, environmental or safety and health consultants or waste management or disposal firms) (each a "LecTec Contractor") will be during the term of this Agreement, in full compliance with all health, safety and environmental laws, statutes, ordinances, regulations, rules, permits and pronouncements. LecTec assumes responsibility for disposing of any and all waste generated during the performance of its responsibilities under this Agreement (including, without limitation, during any manufacturing, storage and transportation activities) in accordance with all legal and professional standards.

6.4.1 LecTec shall Dispose or arrange for the Disposal of Waste and at an Approved Disposal Facility. Novartis shall have the right to unilaterally modify any designation of any Approved Disposal Facility at any time based upon audit and inspection results. LecTec shall only transport Waste to an Approved Disposal Facility by means of a transporter lawfully permitted to transport the particular types of Waste at issue. LecTec shall be solely responsible for the proper Disposal of Waste. For purposes of this Section 6.4.1,

6.4.1.1 "Dispose" or "Disposal" shall mean any discharge, deposit, injection, dumping, spilling, leaking, or placing of any Waste into or on any land or water and the arrangement of any of the foregoing, and shall include any storage, pretreatment, treatment (including incineration), any other

actual disposal, use, sale, sampling or other transfer or application of Waste of any kind or nature whatsoever;

6.4.1.2 "Waste" shall mean, for purposes of this Agreement only, all materials that are produced or generated in connection with the manufacture of any chemical compounds pursuant to this Agreement and for which Disposal is required, including but not limited to materials that are Hazardous Waste, co-product, by-product, chemical compounds that fail to conform to the requirements of this Agreement, wastewaters, residues, wastes, bottoms and other remainders and materials, packaging of, or components of the chemical compounds, and components of any chemical compounds that are not used in the manufacture of the chemical compounds;

6.4.1.3 "Hazardous Waste" shall mean (a) any material or substance defined as or containing materials defined as a "hazardous substance" pursuant to any applicable laws or regulations, including the Comprehensive Environmental Response, Compensation and Liability Act, as amended, the Resource Conservation and Recovery Act, as amended, and any similar successor or supplementary legislation, and the regulations promulgated thereunder, or (b) any material or substance that is radioactive; and

6.4.1.4 "Approved Disposal Facility" shall mean a disposal facility approved by Novartis, which approval shall not be unreasonably withheld.

6.4.2 Notwithstanding anything to the contrary herein, (i) if LecTec and/or any LecTec Contractor fails to comply with the obligations set forth in this Section 6.4, then LecTec shall be responsible for any claims, suits, or liabilities resulting therefrom (including, without limitation, those based on strict liability and joint and several liability), and LecTec shall indemnify, defend and save Novartis (including officers, directors, employees and agents of Novartis) harmless from and against any and all such claims, suits, and liabilities; and (ii) LecTec shall indemnify, defend and save Novartis (including officers, directors, employees and agents of Novartis) harmless from and against any and all claims, suits, and liabilities which arise directly or indirectly from the storage, release, transportation or disposal of chemicals, raw materials, product, waste or any other substance by LecTec and/or any LecTec Contractor.

7. OWNERSHIP

7.1 Novartis Property. All materials, inventions, know-how, trademarks, information, data, writings and other property, in any form whatsoever, which is provided to LecTec by and/or on behalf of Novartis, or which is used by LecTec with respect to the performance of its obligations hereunder, and which was owned by Novartis prior to being provided to LecTec, shall remain the property of Novartis (the "Novartis Property"). LecTec shall have a royalty-free license to use any Novartis Property supplied to it solely to the extent necessary to enable LecTec to perform its obligations hereunder. LecTec shall not acquire any other right, title or interest in the Novartis Property as a result of its performance hereunder. Without limiting the

foregoing, Novartis Property shall include the copyrights and trademarks used in the packaging of the Products ("Packaging IP Rights").

7.2 LecTec Property. All materials, inventions, know-how, trademarks, information, data, writings and other property, in any form whatsoever, which is provided to Novartis by or on behalf of LecTec, or which is used by LecTec with respect to the performance of its obligations hereunder, and which was owned by LecTec prior to its performance or is developed or acquired in the course of such performance hereunder, shall remain the property of LecTec (the "LecTec Property"). Novartis shall acquire no right, title or interest in the LecTec Property as a result of LecTec's performance hereunder. Without limiting the foregoing, as between the parties hereto, all the intellectual property rights for the Products other than the Packaging IP Rights shall be deemed to be LecTec Property.

7.3 Effect of Termination. Upon the termination of this Agreement, each party shall return to its owner all Novartis Property or LecTec Property, as

applicable, except for one copy which may be retained in the returning party's confidential files.

8. TRADE SECRETS, CONFIDENTIALITY AND PUBLICITY

8.1 Confidential Information. During the period that this Agreement is in effect and thereafter, LecTec and Novartis shall not disclose to anyone in any manner whatsoever or use for any purpose other than its performance of this Agreement (except as authorized in writing by the disclosing party) any information it receives from the other party ("Confidential Information"), including, without limitation, intellectual property, inventions, works of authorship, trade secrets or know-how or other information relating in any way to the Products, processes, and services of the other party.

8.2 Limitations. Each party shall limit disclosure of Confidential Information received hereunder to only those of its employees who are directly concerned with the performance of any activities with respect to which the Confidential Information was disclosed. Each party agrees to advise those of its employees who receive any other party's Confidential Information that such Confidential Information (a) is proprietary and confidential to such party and (b) shall not be disclosed to anyone except as authorized by this Agreement or otherwise authorized by such party in writing. Each party further agrees to take at least such precautions as it normally takes with its own Confidential Information to prevent unauthorized disclosure of the other party's Confidential Information.

8.3 Injunctive Relief. Each party acknowledges that any unauthorized disclosure of any portion of the other party's Confidential Information shall cause irreparable injury to the other party and that no adequate or complete remedy shall be available at law to such other party to compensate for such injury. Accordingly, each party hereby also acknowledges that the other party shall be entitled to injunctive relief in the event of such unauthorized disclosure by a party or any of its employees in addition to whatever other remedies it might have at law.

8.4 Effect of Termination. Upon termination of this Agreement, each party shall return to the other all copies of the other party's Confidential Information, and shall make no further use of such Confidential Information, except for one copy which may be retained in the receiving party's confidential files.

8.5 Exceptions. The obligations of this Section 8 shall not apply to - - -information.

8.5.1 that is or has been in the possession of the recipient prior to receipt of the same from the disclosing party as evidenced by recipient's written records;

8.5.2 which the recipient lawfully obtains from any third party not under an obligation to the disclosing party to hold the same in confidence;

8.5.3 that is published or becomes part of the public domain without breach of any undertakings discussed hereinabove;

8.5.4 that is independently developed by personnel of the recipient without any use of or reliance upon the disclosing party's Confidential Information; or

8.5.5 that is required to be disclosed pursuant to judicial process, court order or administrative request, or that is otherwise required for any regulatory filing, provided that the recipient shall notify the other party sufficiently prior to disclosing such Confidential Information as to permit such other party to seek a protective order.

8.6 Press Releases. LecTec shall not issue any press release or other public statement disclosing the existence of or relating to this Agreement without prior written consent of Novartis, which consent shall not be unreasonably withheld or delayed. The foregoing shall not limit LecTec's rights to make such disclosures as reasonably required by applicable securities laws or

the rules of any stock exchange where its securities are traded.

9. QUALITY OF THE PRODUCT; COMPLIANCE WITH LAW

9.1 Representations and Warranties. LecTec hereby represents and warrants that:

9.1.1 no Products constituting or being a part of any shipment hereunder shall at the time of any such shipment be (i) adulterated or misbranded within the meaning of the Federal Food, Drug and Cosmetic Act, as amended from time to time (the "Act"), or regulations promulgated thereunder, as such law or regulation is constituted and in effect at the time of any such shipment, or (ii) an article which may not, under the provisions of Sections 404, 505 or 512 of the Act, be introduced into interstate commerce;

9.1.2 all Products furnished to Novartis hereunder shall be in full compliance with the Specifications, and shall remain in full compliance with the Specifications for the full period of the expected shelf-life of such Products, so long as the Products are stored in accordance with the Specifications;

9.1.3 LecTec shall perform its obligations hereunder in compliance with any materially applicable federal, state and local laws and regulations, including without limitation the Act, the FDA's then-current Good Manufacturing Practices ("cGMP"), and any health, safety and environmental laws and regulations materially applicable to LecTec's manufacture and packaging of the Products and its other performance hereunder;

9.1.4 all Products furnished to Novartis hereunder shall have been manufactured in accordance with the terms of the QA Agreement;

9.1.5 LecTec's manufacturing, laboratory and packaging facilities shall remain in compliance with CGMP at all times during the term of this Agreement to the extent applicable to the manufacture and packaging of the Products; and

9.1.6 LecTec owns or has the right to use all necessary copyright, trademark, patents, trade secrets and other intellectual property rights which it shall use to perform its obligations hereunder with respect to the Territory.

9.2 Disclaimer. EXCEPT AS OTHERWISE SPECIFICALLY PROVIDED IN THIS AGREEMENT, LECTEC MAKES NO WARRANTY OF ANY KIND, EXPRESS OR IMPLIED, CONCERNING THE PRODUCTS, OR THE MERCHANTABILITY OR FITNESS THEREOF FOR ANY PURPOSE.

9.3 Remedy. In the event that Products are delivered to Novartis by LecTec which are not in compliance with the warranties made in Section 9.1 then, at Novartis' option (i) LecTec shall replace the non-compliant Products at no additional charge (which replacement Products shall be delivered to Novartis as soon as reasonably practicable, but in no event more than ninety (90) days after the initial notification by Novartis); or (ii) LecTec shall credit Novartis' account in the amount of the price of the non-compliant Products. Novartis shall give commercially reasonable cooperation to LecTec to determine the nature and extent of any problem giving rise to a breach of warranties, including, without limitation, prompt samples of any allegedly non-compliant Products. Returns of non-compliant Products shall be subject to the provisions of Section 4.3.

10. INDEMNIFICATION AND INSURANCE

10.1 Novartis Indemnification. Novartis shall defend, indemnify and hold LecTec harmless against any and all claims, damages, expenses, reasonable attorneys' fees, settlement costs and judgments arising out of any death, personal injury, bodily injury or property damage to a third party alleged to have been caused by the Products, except to the extent that such injury or damage was the result of any breach of this Agreement by LecTec, including any warranty contained herein, or the result of any latent defects in the Products caused by the negligence or willful misconduct of LecTec. LecTec shall promptly notify Novartis of any such claim or action, shall reasonably cooperate with Novartis in the defense of such claim or action, and shall permit Novartis to control the defense and settlement of such claim or action, all at Novartis' cost and expense.

10.2 LecTec Indemnification. LecTec shall defend, indemnify and hold Novartis harmless against any and all claims, damages, expenses, reasonable attorneys' fees, settlement costs and judgments arising out of any death, personal injury, bodily injury or property damage to a third party to the extent that such death, injury or damage is the result of (i) any breach of this Agreement by LecTec, including any warranty contained herein; (ii) any claim regarding a work-related death or injury to any LecTec employee; (iii) any claim regarding latent defects in the Products caused by the negligence or willful misconduct of LecTec; or (iv) any claim that the Products, or any means used to manufacture the Products, infringe any third party's patent, trade secret, trademark, copyright, or other proprietary interest in the Territory. Novartis shall promptly notify LecTec of any such claim or action, shall reasonably cooperate with LecTec in the defense of such claim or action, and shall permit LecTec to control the defense and settlement of such claim or action, all at LecTec's cost and expense.

10.3 Product Recalls and Withdrawals. Each party shall promptly notify the other party of any legal and/or factual circumstances which might, under applicable laws and regulations, necessitate a field correction, recall or withdrawal of any Products (collectively, a "Regulatory Recall") and shall consult with each other regarding the appropriate steps to be taken. Novartis shall determine whether any Regulatory Recall shall take place. Novartis shall notify all regulatory authorities of any such Regulatory Recall, and shall take all steps necessary to effectuate such Regulatory Recall. LecTec shall assist Novartis in each of these activities to the extent reasonably requested by Novartis. LecTec shall reimburse Novartis for the costs of any such Regulatory Recall to the extent such Regulatory Recall was made necessary by the actions or inaction of LecTec. If LecTec is unable in good faith to obtain the recall insurance required by Section 10.4.6 for a reasonable premium, then the maximum amount which LecTec shall be required to reimburse Novartis pursuant to the preceding sentence shall be $500,000 per Regulatory Recall, not including the cost of any replacement Products made necessary by the applicable Regulatory Recall. Novartis shall reimburse LecTec for the costs of any such Regulatory Recall to the extent such Regulatory Recall was made necessary by the actions or inaction of Novartis. Any claim for such reimbursement of costs incurred in such a Regulatory Recall shall be subject to audit by the CPA Firm.

10.4 LecTec's Insurance Coverage. LecTec shall obtain, at its own expense, policies of insurance in amounts no less than those specified below and shall cause its carrier or carriers to name Novartis as an additional insured on those coverages marked with an (*) below:

*10.4.1 *general liability insurance with combined limits of not less than $1,000,000 per occurrence and $1,000,000 per accident for bodily injury, including death, and property damage;*

10.4.2 workers' compensation and disability insurance in the amounts required by the law of the state(s) in which its workers are located, and employer's liability insurance with limits of not less than $1,000,000 per occurrence;

*10.4.3 *automobile liability insurance (in the event that the use of an automobile by LecTec is required in the performance of this Agreement) with combined limits of not less*

than $1,000,000 per occurrence and $1,000,000 per accident for bodily injury, including death, and property damage is required;

*10.4.4 *product liability insurance with limits not less than $5,000,000;*

10.4.5 property insurance for the replacement value of the facilities and equipment used to produce the Products;

*10.4.6 *recall insurance with limits not less than $2,000,000; and*

*10.4.7 *excess insurance with limits not less than $5,000,000.*

10.5 Documentation of Coverage. Upon request, LecTec shall provide to Novartis evidence of its insurance or self insurance. LecTec shall provide Novartis thirty (30) days prior written notice of any cancellation or material change in coverage.

10.6 Novartis' Insurance Coverage. Novartis warrants and represents to LecTec that Novartis maintains a policy or program of insurance or self-insurance at levels sufficient to support the indemnification obligations assumed herein. Upon request, Novartis shall provide to LecTec evidence of its insurance or self-insurance. Novartis shall provide to LecTec thirty (30) days prior written notice of any cancellation or material change in coverage.

11. TERM AND TERMINATION

11.1 Initial Term; Renewal. This Agreement shall commence on the Effective Date and shall continue in effect for five (5) years (the "Initial Term") and, thereafter, shall be renewed for subsequent one (1) year terms upon the mutual consent of the parties.

11.2 Termination for Convenience. Notwithstanding Section 11.1, Novartis may terminate this Agreement for convenience at no cost, at any time, by giving LecTec at least six (6) months prior written notice thereof.

11.3 Termination for Cause. In the event LecTec is unable for three (3) consecutive months to supply Products which comply with LecTec's obligations hereunder in quantities sufficient to meet Novartis' purchase orders under Section 3.2, then Novartis may terminate this Agreement at no cost upon ten (10) days prior written notice thereof. In addition, if either party materially breaches this Agreement, the other party shall give such breaching party written notice thereof with reasonable detail. If the breaching party fails to cure such breach within forty-five (45) days of its receipt of such notice, then the non-breaching party may terminate this Agreement at no cost upon written notice thereof. In addition, either party may terminate this Agreement with immediate effect upon giving written notice to the other party in the event of insolvency, assignment for the benefit of creditors, or bankruptcy proceedings by or against the other party.

11.4 Survival. Notwithstanding any termination of this Agreement, the provisions of Sections 1.6, 1.7, 2.1, 2.2, 2.4, 2.5, 2.6, 2.9, 5.3, 6.4.2, 7, 8, 9, 10 and 13 shall remain in effect.

12. AUDIT AND INSPECTION RIGHTS

12.1 Audit, Inspection and Observation. During the term of this Agreement and any renewal thereof, Novartis shall have the right, at its sole cost and expense, to send Novartis representatives to audit, inspect and observe the manufacture, storage, disposal and transportation of the Products, and all other materials reasonably related thereto or used in connection therewith, upon reasonable prior notice to LecTec and during LecTec's normal business hours. Such Novartis representatives shall have no responsibility or authority for supervision of LecTec employees performing such manufacture, storage, disposal or transportation operations. Such Novartis representatives shall comply with any reasonable LecTec health, safety or security rules or policies while at LecTec's premises. The audit, inspection and observations rights set forth in this Section 12.1 are solely for the purpose of determining LecTec's compliance with the terms of this Agreement and the QA Agreement.

12.2 Action Plan. If, as a result of any such audit, inspection or observation under Section 12.1, Novartis reasonably concludes that LecTec is not in compliance with any of its obligations hereunder, it shall so notify LecTec in writing, specifying such areas of non-compliance in reasonable detail. LecTec shall provide to Novartis within thirty (30) days of Novartis' request a written action plan with a time line for resolution of the problems identified within a reasonable, mutually agreed upon time frame.

12.3 Government Inspections. LecTec shall inform Novartis within twenty-four (24) hours of any notification to LecTec of any site visits to the LecTec facility by the FDA, state or federal regulatory agencies or any other governmental or regulatory agency, relating, directly or indirectly, to the manufacture of the Products, and shall provide to Novartis all other materials related thereto or used in connection therewith. Novartis shall have the option of participating in any site visit by any governmental or regulatory agency (except to the extent such governmental or regulatory agency visitor objects) if the site visit relates, directly or indirectly, to the manufacturing, storage, disposal and transportation of the Products. If Novartis does not participate in the site visit for any reason, LecTec shall report in writing the results of the visit to Novartis within seven (7) days of the occurrence thereof. In the event that any such governmental or regulatory agency finds that the site is deficient or unsatisfactory in any material respect, LecTec shall cure all such material deficiencies within the earlier of ninety (90) days or such cure period as ordered by the government or regulatory agency. If all such deficiencies are not cured by LecTec within the required time frame, Novartis may deem such condition to be a material breach of this Agreement without the required 45-day cure period in Section 11.2 of this Agreement and thus may immediately terminate this Agreement.

13. MISCELLANEOUS

13.1 Waiver. Each party acknowledges and agrees that any failure on the part of the other party to enforce at any time, or for any period of time, any of the provisions of this Agreement shall not be deemed or construed to be a waiver of such provisions or of the right of such other party thereafter to enforce each an every such provision.

13.2 Enforcement. If and to the extent that any provision of this Agreement is determined by any legislature, court or administrative agency to be, in whole or in part, invalid or unenforceable, such provision or part thereof shall be deemed to be surplusage and, to the extent not so determined to be invalid or unenforceable, each provision hereof shall remain in full force and effect unless the purposes of this Agreement cannot be achieved. In the event any provisions shall be held invalid, illegal or unenforceable the parties shall use commercially reasonable efforts to substitute a valid, legal and enforceable provision which insofar as practical implements the purposes hereof.

13.3 Choice of Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Minnesota as though made and to be fully performed in said State.

13.4 Notices. All notices required or permitted hereunder shall be given in writing and sent by confirmed facsimile transmission, or mailed postage prepaid by first-class certified or registered mail, or sent by a nationally recognized express courier service, or hand-delivered to the following addressees:

Novartis: Novartis Consumer Health, Inc.
560 Morris Avenue
Summit, NJ 07901
Attn: General Counsel

LecTec: LecTec Corporation
10701 Red Circle Dr.
Minnetonka, MN 55343
Attn: Chief Executive Officer

or to such other address as may be specified in a notice given to the other party in accordance with this Section 13.4. Any notice, if sent properly addressed, postage prepaid, shall be deemed made three (3) days after the date of mailing as indicated on the certified or registered mail receipt, or on the next business day if sent by express courier service or on the date of delivery or transmission (if delivered or sent during ordinary business hours, otherwise on the next business day) if hand-delivered or sent by confirmed facsimile transmission.

13.5 Captions. The captions of each section of this Agreement are inserted

only as a matter of convenience and for reference and in no way shall be deemed to define, limit, enlarge, or describe the scope of this Agreement and the relationship of the parties hereto, and shall not in any way affect this Agreement or the construction of any provisions herein.

13.6 Entire Agreement; Amendment. This Agreement, including all Exhibits annexed hereto (which are incorporated herein by reference), represents and incorporates the entire understanding between the parties hereto with respect to the subject matter of this Agreement and supersedes any prior offers, proposals, drafts or other communications with respect thereto. Each party acknowledges that there are no warranties, representations, covenants or

understandings of any kind, nature or description whatsoever made by any party to any other, except such as are expressly hereinabove set forth. This Agreement shall not be subject to change or modification except by the execution of a writing specified to be an explicit amendment to this Agreement duly executed by all parties hereto.

13.7 Effect of Forms. The parties recognize that, during the term of this Agreement, a purchase order, acknowledgment form or similar routine document (collectively, "Forms") may be used to implement or administer provisions of this Agreement. Therefore, the parties agree that the terms of this Agreement shall prevail in the event of any conflict between this Agreement and the printed provisions of such Forms, or typed provisions of Forms that appear to add to, vary, modify or conflict with the provisions of this Agreement.

13.8 Relationship. Nothing in this Agreement shall create between the parties a partnership, joint venture or principal-agent relationship and, for the avoidance of doubt, each of LecTec and Novartis now confirms and accepts that it is an independent contractor trading for and on its own behalf.

13.9 Assignment. LecTec may not assign or otherwise transfer this Agreement or any interest herein or any right hereunder (other than to an affiliate) without the prior written consent of Novartis, which consent shall not be unreasonably withheld, except that LecTec may assign this Agreement in connection with the transfer or sale of all or substantially all of its assets or business or its merger or consolidation with another company, so long as (i) such acquiror or successor in interest agrees in writing to be bound by all the terms and conditions hereof; and (ii) LecTec shall first give Novartis written notice of any such assignment, and fifteen (15) days to object thereto. The only grounds upon which Novartis may object to such an assignment are if such acquiror or successor in interest is (a) a direct competitor of Novartis; (b) in Novartis' reasonable discretion, is not a manufacturer which has a proven record of operational quality at least equal to that of LecTec; or (c) in Novartis' reasonable discretion, does not have sufficient financial wherewithal. Any purported assignment, transfer, or attempt to assign or transfer any interest or right hereunder except in compliance with this Section 13.9 shall be null, void and of no effect.

13.10 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall constitute an original and all of which together shall constitute a single instrument.

13.11 Force Majeure. A party shall not be liable for delayed performance or non-performance of this Agreement (other than payment of money when due) if such condition is due to events beyond its reasonable control, including, without limitation, fire, flood, storm, earthquake, any other Act of God, electrical or computer failures, supply or labor shortages, strikes, riot, civil disorder, war or government order or decree.

13.11.1 A party claiming relief under this Section 13.11 shall give prompt written notice thereof to the other party, together with its best estimate of when such condition will end and its full performance may be resumed.

13.11.2 In the event of a Force Majeure, or if for any other reason LecTec experiences any shortage and is therefore unable to supply Novartis with the full quantity of Products and with the delivery date as ordered by Novartis and accepted by LecTec, then Novartis shall be entitled to the same proportionate quantity of available Vapor Patches as the quantity of Products purchased by Novartis from LecTec in the twelve (12) months preceding the shortage bears to all orders for Vapor Patches received by LecTec from all its customers during such period, including LecTec's sales to Novartis, and including LecTec's sales of Comparable Products directly to retailers under its "TheraPatch" tradename, or under any Other LecTec Trade Name. 13.11.3 Notwithstanding the foregoing, if such condition continues without change for more than ninety (90) days, the other party may then elect to treat such delayed performance or non-performance as a material breach of this Agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

LECTEC CORPORATION	*NOVARTIS CONSUMER HEALTH, INC.*
By: /s/ Rodney A. Young	*By: /s/ Thomas E. Berry*
Name: Rodney A. Young	*Name: Thomas E. Berry*
Title: Chairman/CEO/President	*Title: Sr V P Supply Chain & Production*
Date: 5/15/00	*Date: 5/23/00*

EXHIBIT A
THE PRODUCTS

1. Packages of six (6) menthol-scented hydrogel patches containing menthol, camphor, eucalyptus oil, and fragrance used for the topical application of vapor active ingredients for relief of symptoms due to coughs and colds.

2. Packages of six (6) mentholated cherry-scented hydrogel patches containing menthol, camphor, eucalyptus oil, and fragrance used for the topical application of vapor active ingredients for relief of symptoms due to coughs and colds.

EXHIBIT C
PRODUCT PRICING AND MINIMUM PURCHASE REQUIREMENTS

FUNDING REQUIREMENTS	*STANDARD PRODUCT/PRIVATE LABEL*
Concept Phase	*(*)*
Feasibility Phase	*(*)*
Salesmen's Samples	*(*)*
Completion of Design Phase	*(*)*
Transfer Phase	*(*)*

(*)

PRICING
- - -------
Finished product: Price per patch: *(*)*
Per 6-patch folding carton: *(*)*
Per 24-carton case: *(*)*

ANNUAL MINIMUM PURCHASE REQUIREMENTS FOR US PEDIATRIC EXCLUSIVITY
- - ----------
(*)

** Denotes confidential information that has been omitted from the exhibit and filed separately, accompanied by a confidential treatment request, with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934.*

EXHIBIT D
TERRITORY

United States of America

EXHIBIT 21.01

Subsidiaries of the Company

LecTec International Corporation
Dissolved effective December 31, 1999

Incorporated in the state of Minnesota

Registered office: *10701 Red Circle Drive*
Minnetonka, MN 55343

Corporate office: *55-11 Curacao Gade*
P. O. Box 309420
Charlotte Amalie
St. Thomas, Virgin Islands 00803-9420

Records office: *C/O Chase Trade, Inc.*
55-11 Curacao Gade
P. O. Box 309420
Charlotte Amalie
St. Thomas, Virgin Islands 00803-9420

EXHIBIT 23.01

CONSENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

We have issued our report dated August 18, 2000 (except for Note B, as to which the date is September 26, 2000) accompanying the consolidated financial statements included in the Annual Report of LecTec Corporation and Subsidiaries on Form 10-K for the year ended June 30, 2000. We hereby consent to the incorporation by reference of said report in the Registration Statements of LecTec Corporation on Form S-3 (File No. 333-40183, effective November 17, 1997) and Forms S-8 (File No. 33-121780, effective April 21, 1987, File No. 33-45931, effective February 21, 1992, File No. 333-46283, effective February 13, 1998, File No. 333-46289, effective February 13, 1998, File No. 333-72569, effective February 18, 1999 and File No. 333-72571, effective February 18, 1999).

/s/ GRANT THORNTON LLP

Minneapolis, Minnesota
September 27, 2000

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