

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 1999.

☐ 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

55343

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (612) 933-2291

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 ☒ No ☐

The number of shares outstanding of the registrant's common stock as of February 10, 2000 was 3,890,494 shares.

LECTEC CORPORATION

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 1999

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PART I - FINANCIAL INFORMATION

ITEM 1- FINANCIAL STATEMENTS AND NOTES TO FINANCIAL STATEMENTS

LECTEC CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

<TABLE>
<CAPTION>

	December 31, 1999	June 30, 1999
	(Unaudited)	
<S>	<C>	<C>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 20,491	\$ 1,022,025
Receivables		
Trade, net of allowances of \$115,035 (unaudited) and \$101,751 at December 31, 1999 and June 30, 1999	1,960,300	2,335,314
Refundable income taxes	--	7,544
Other	5,965	8,687
	1,966,265	2,351,545
Inventories		
Raw materials	1,728,921	1,324,973
Work-in-process	2,190	69,324
Finished goods	416,752	602,227
	2,147,863	1,996,524
Prepaid expenses and other	245,260	174,674
Deferred income taxes	354,000	354,000
	4,733,879	5,898,768
Total current assets		
PROPERTY, PLANT AND EQUIPMENT - AT COST		
Land	247,731	247,731
Building and improvements	1,937,568	1,841,742
Equipment	7,308,394	7,157,016
Furniture and fixtures	413,013	413,013
	9,906,706	9,659,502
Less accumulated depreciation	6,031,174	5,631,011
	3,875,532	4,028,491
OTHER ASSETS		
Patents and trademarks, less accumulated amortization of \$1,228,437 (unaudited) and \$1,154,698 at December 31, 1999 and June 30, 1999	170,267	199,971
Other	5,343	5,343
	175,610	205,314
	\$ 8,785,021	\$10,132,573

</TABLE>

See accompanying notes to the consolidated financial statements.

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LECTEC CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS - CONTINUED

<TABLE>
<CAPTION>

	December 31, 1999	June 30, 1999
	(Unaudited)	
<S>	<C>	<C>
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 1,678,195	\$ 1,676,776
Accrued expenses		
Payroll related	392,075	403,075
Retail support programs	208,303	165,472
Other	172,562	181,730
	2,451,135	2,427,053
Total current liabilities		

DEFERRED INCOME TAXES	197,000	197,000
-----------------------	---------	---------

SHAREHOLDERS' EQUITY

Common stock, \$.01 par value: 15,000,000 shares authorized;
3,890,494 shares (unaudited) and 3,876,476 shares issued
and outstanding at December 31, 1999 and June 30, 1999

	38,905	38,765
Additional paid-in capital	11,289,329	11,262,654
Accumulated other comprehensive loss	(11,841)	(11,841)
Deficit in retained earnings	(5,179,507)	(3,781,058)

	6,136,886	7,508,520
--	-----------	-----------

\$	8,785,021	\$ 10,132,573
----	-----------	---------------

</TABLE>

See accompanying notes to the consolidated financial statements.

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LECTEC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

<TABLE>

<CAPTION>

	Three months ended December 31,		Six months ended December 31,	
	1999	1998	1999	1998
<S>	<C>	<C>	<C>	<C>
Net sales	\$ 3,299,705	\$ 3,103,277	\$ 6,308,457	\$ 6,006,334
Cost of goods sold	2,236,691	2,177,539	4,306,162	4,063,343
Gross profit	1,063,014	925,738	2,002,295	1,942,991
Operating expenses				
Sales and marketing	863,655	545,938	1,598,700	879,471
General and administrative	688,783	781,630	1,247,873	1,368,091
Research and development	310,202	286,025	579,964	566,038
	1,862,640	1,613,593	3,426,537	2,813,600
Loss from operations	(799,626)	(687,855)	(1,424,242)	(870,609)
Other income, net	4,459	26,987	25,793	58,788
Loss before income taxes	(795,167)	(660,868)	(1,398,449)	(811,821)
Income tax expense	--	348	--	1,612
Net loss	\$ (795,167)	\$ (661,216)	\$ (1,398,449)	\$ (813,433)
Net loss per share - basic and diluted	\$ (0.20)	\$ (0.17)	\$ (0.36)	\$ (0.21)
Weighted average shares outstanding - basic and diluted	3,881,352	3,907,995	3,878,914	3,945,599

</TABLE>

See accompanying notes to the consolidated financial statements.

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LECTEC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

<TABLE>

<CAPTION>

Six Months Ended December 31,

	1999	1998
<S>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (1,398,449)	\$ (813,433)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	473,902	451,861
Changes in operating assets and liabilities:		
Trade and other receivables	385,280	(424,723)
Refundable income taxes	--	52,000
Inventories	(151,339)	(166,901)
Prepaid expenses and other	(70,586)	(125,614)
Accounts payable	1,419	608,632
Accrued expenses	22,663	(50,539)
Net cash used in operating activities	(737,110)	(468,717)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(247,204)	(177,038)
Investment in patents and trademarks	(44,035)	(53,448)
Net cash used in investing activities	(291,239)	(230,486)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock	26,815	--
Repurchases and retirement of common stock	--	(464,874)
Net cash provided by (used) in financing activities	26,815	(464,874)
Net decrease in cash and cash equivalents	(1,001,534)	(1,164,077)
Cash and cash equivalents at beginning of period	1,022,025	2,186,532
Cash and cash equivalents at end of period	\$ 20,491	\$ 1,022,455

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the period for:		
Interest expense	\$ 2,137	\$ --
Income taxes	--	22,010

</TABLE>

See accompanying notes to the consolidated financial statements.

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LECTEC CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED DECEMBER 31, 1999 AND 1998
(UNAUDITED)

(1) GENERAL

The accompanying consolidated financial statements include the accounts of LecTec Corporation (the "Company") and LecTec International Corporation, a wholly-owned subsidiary which was dissolved and merged into LecTec Corporation on December 31, 1999. All significant intercompany balances and transactions have been eliminated in consolidation. The Company's financial statements for the three months and six months ended December 31, 1999 should be read in conjunction with its Annual Report on Form 10-K and its Annual Report to Shareholders for the fiscal year ended June 30, 1999. The interim financial statements are unaudited and in the opinion of management, reflect all adjustments necessary for a fair presentation of results for the periods presented. Results for interim periods are not necessarily indicative of results for the year.

(2) NET LOSS

The Company's basic net loss per share amounts have been computed by dividing net loss by the weighted average number of outstanding common shares. The Company's diluted net loss per share amounts have been computed by dividing net loss by the weighted average number of outstanding common shares and common share equivalents, when dilutive. Options and warrants to purchase 1,044,003 and 873,066 shares of common stock with a weighted average exercise price of \$6.20 and \$7.70 were outstanding during the three months ended December 31, 1999 and

1998, but were excluded because they were antidilutive. Options and warrants to purchase 1,093,443 and 870,323 shares of common stock with a weighted average exercise price of \$6.35 and \$7.72 were outstanding during the six months ended December 31, 1999 and 1998, but were excluded because they were antidilutive.

(3) COMPREHENSIVE LOSS

For the quarter and six months ended December 31, 1999 and 1998, there were no items which the Company is required to recognize as components of comprehensive income (loss), therefore comprehensive loss was the same as net loss.

(4) SEGMENTS

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 has 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:

Three months ended December 31,	1999	1998
	-----	-----
Conductive products	\$1,927,578	\$1,955,025
Medical tape products	452,572	718,537
Therapeutic consumer products	919,555	429,715
	-----	-----
	\$3,299,705	\$3,103,277
	=====	=====

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Six months ended December 31,	1999	1998
	-----	-----
Conductive products	\$3,504,361	\$3,929,571
Medical tape products	1,021,362	1,466,420
Therapeutic consumer products	1,782,734	610,343
	-----	-----
	\$6,308,457	\$6,006,334
	=====	=====

(5) LINE OF CREDIT AND LIQUIDITY

In November 1999, the Company finalized a \$2,000,000 line of credit which expires in November 2001. The line of credit is secured by the Company's receivables, inventory and equipment, and bears interest at the lending bank's prime rate plus three percentage points. There were no borrowings outstanding on the line of credit as of December 31, 1999, nor during the three months then ending. The credit agreement contains certain restrictive covenants which require the Company to maintain, among other things, specified levels of net worth and not to exceed specified cumulative losses. Defaults by the Company on certain financial covenants as of November 30 and December 31, 1999 were waived by the bank in February 2000 and the line of credit agreement was amended to adjust specified levels of these covenants for the months ending January 31 and February 29, 2000.

The Company experienced negative cash flow from operations of \$737,110 for the six months ending December 31, 1999. This cash requirement was satisfied principally from existing cash balances. Management believes that internally generated cash flow and the new line of credit will be sufficient to support operating requirements in the near term.

(6) 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 quarter ended December 31, 1999 no shares were repurchased and during the quarter ended December 31, 1998, 74,800 shares were repurchased for \$223,663. During the six months ended December 31, 1999 no shares were repurchased and during the six months ended December 31, 1998, 165,650 shares were repurchased for \$524,338. Through December 31, 1999 the Company has repurchased a total of 205,150 shares at a cost of \$667,963 under this program.

(7) 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 of which 14,018 shares were purchased by employees for \$26,815 during the first six months of fiscal 2000. As of December 31, 1999 employees have purchased a total of 29,144 shares for \$59,821.

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PART I - FINANCIAL INFORMATION

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

QUARTERS AND SIX MONTHS ENDED DECEMBER 31, 1999 AND 1998

RESULTS OF OPERATIONS

Net sales for the second quarter of fiscal 2000 were \$3,299,705 compared to net sales of \$3,103,277 for the second quarter of fiscal 1999, an increase of 6.3%. The increase was primarily the result of increased therapeutic consumer product sales which more than offset decreased medical tape and conductive product sales. Therapeutic consumer product sales increased by 114.0% from \$429,715 to \$919,555 while conductive product sales, the Company's largest product group, decreased slightly by 1.4% and medical tape product sales decreased by 37.0%. The therapeutic consumer product sales increase was primarily the result of increased TheraPatch(R) sales volume, especially TheraPatch Vapor products. The decrease in medical tape product sales was primarily due to the absence of sales to a former low-margin slit roll tape customer and decreases in sales volume to several other low-margin medical tape customers.

Net sales for the first six months of fiscal 2000 were \$6,308,457 compared to net sales of \$6,006,334 for the first six months of fiscal 1999, an increase of 5.0%. The increase was primarily the result of increased therapeutic consumer product sales which more than offset decreased medical tape and conductive product sales. Therapeutic consumer product sales increased by 192.1% from \$610,343 to \$1,782,734 while conductive product sales, the Company's largest product group, decreased by 10.8% and medical tape product sales decreased by 30.4%. The therapeutic consumer product sales increase was primarily the result of increased TheraPatch sales volume, especially TheraPatch Vapor products. The conductive product sales decrease was primarily the result of the absence of sales to a former customer who began manufacturing their own product in the fourth quarter of fiscal 1999. Sales to the former customer in the first six months of fiscal 1999 were approximately \$338,000. Medical tape product sales decreased primarily due to reduced sales to a low-margin slit roll tape customer and decreases in sales volume to several other low-margin medical tape customers.

Gross profit for the second quarter of fiscal 2000 was \$1,063,014 compared to \$925,738 for the second quarter of fiscal 1999, an increase of 14.8%. Gross profit as a percent of net sales for the second quarter of fiscal 2000 was 32.2% compared to 29.8% for the second quarter of fiscal 1999. The increase in gross profit for the quarter resulted primarily from the favorable impact of a change in the sales mix toward higher-margin therapeutic consumer products and increased sales volume which more than offset increased labor costs. Labor costs were higher in the current quarter primarily due to an increase in staffing levels and overtime related to the production of therapeutic patch products.

Gross profit for the first six months of fiscal 2000 was \$2,002,295 compared to \$1,942,991 for the first six months of fiscal 1999, an increase of 3.1%. Gross profit as a percent of net sales for the first six months of fiscal 2000 was 31.7% compared to 32.3% for the first six months of fiscal 1999. The increase in gross profit dollars for the six months resulted primarily from the favorable impact of a change in the sales mix toward higher-margin therapeutic consumer products which more than offset increased labor, depreciation, and repairs and maintenance expense. Labor costs were higher in the current six months primarily due to an increase in staffing levels and overtime related to the production of therapeutic patch products.

Sales and marketing expenses were \$863,655 and \$545,938 during the second quarters of fiscal 2000 and 1999, and as a percentage of net sales, were 26.2% and 17.6%. The increase in sales and marketing expense for the quarter was primarily due to increased cooperative and media advertising expenses and retail slotting fees related to sales of the TheraPatch product line. The Company anticipates that sales and marketing expenses as a percent of sales for the remainder of fiscal 2000 will

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be comparable to the second quarter of fiscal 2000 due to marketing programs associated with the TheraPatch product line.

Sales and marketing expenses were \$1,598,700 and \$879,471 during the first six months of fiscal 2000 and 1999, and as a percentage of net sales, were 25.3% and 14.6%. The increase in sales and marketing expense for the first six months was primarily due to increased retail slotting fees and advertising expenses related to the TheraPatch product line.

General and administrative expenses were \$688,783 and \$781,630 during the second quarters of fiscal 2000 and 1999, and as a percentage of net sales, were 20.9% and 25.2%. The decrease in general and administrative expenses for the quarter was primarily due to decreased legal expenses. Legal expenses in the prior year quarter included approximately \$126,000 of expenses associated with the re-negotiation and modification of the license agreement for the development and commercialization of cotinine.

General and administrative expenses were \$1,247,873 and \$1,368,091 during the first six months of fiscal 2000 and 1999, and as a percentage of net sales, were 19.8% and 22.8%. The decrease in general and administrative expenses for the first six months of fiscal 2000 was primarily due to decreased legal expenses.

Research and development expenses for the second quarters of fiscal 2000 and 1999 were \$310,202 and \$286,025, and as a percentage of net sales, were 9.4% and 9.2%. The increase in research and development expense for the current quarter primarily reflects increased labor costs of personnel working on therapeutic consumer products under development.

Research and development expenses for the first six months of fiscal 2000 and 1999 were \$579,964 and \$566,038, and as a percentage of net sales, were 9.2% and 9.4%. The increase in research and development expense for the first six months of fiscal 2000 primarily reflects increased labor costs which were partially offset by a decrease in test-run production costs.

Other income, net, decreased in the second quarter of fiscal 2000 to \$4,459 from \$26,987 in the second quarter of fiscal 1999. Other income, net, decreased in the first six months of fiscal 2000 to \$25,793 from \$58,788 in the first six months of fiscal 1999. Both of the fiscal 2000 decreases were primarily the result of decreased interest income due to lower cash and cash equivalent balances.

The Company recorded a loss before income taxes of \$795,167 in the second quarter of fiscal 2000 compared to a loss before income taxes of \$660,868 for the second quarter of fiscal 1999. The Company recorded a loss before income taxes of \$1,398,449 in the first six months of fiscal 2000 compared to a loss before income taxes of \$811,821 for the first six months of fiscal 1999. The increased loss in the current year second quarter and first six months was primarily the result of increased sales and marketing expenses related to retail sales of the Company's TheraPatch products. The increased sales and marketing expenses more than offset an increase in gross profit that resulted from a shift in the sales mix toward higher-margin therapeutic consumer products. The Company expects to incur similar losses for the remainder of fiscal 2000 as it continues to incur increased sales and marketing expenses related to retail sales of TheraPatch consumer products.

The Company recorded no income tax expense or benefit in the second quarter and first six months of fiscal 2000 compared to nominal income tax expense in the second quarter and first six months of the prior year. There was no income tax benefit recorded during the second quarter and first six months of fiscal 2000 since the loss benefit may not be realizable by the Company. Income tax expense in the second quarter and first six months of fiscal 1999 reflects minimal tax expense associated with the Company's foreign sales corporation subsidiary.

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 \$1,001,534 to \$20,491 during the first six months of fiscal 2000. Accounts receivable decreased by \$385,280 to \$1,966,265 primarily due to a reduction in accounts more than 60 days old. Inventories increased by \$151,339 to \$2,147,863 primarily due to increased raw materials inventory related to therapeutic products which was partially offset by decreased finished goods inventory of medical tape. Accounts payable of \$1,678,195 at December 31, 1999 were virtually unchanged during the first six months of fiscal 2000. Capital spending for manufacturing equipment and plant improvements totaled \$247,204 during the first six months of fiscal 2000. There were no material commitments for capital expenditures at December 31, 1999.

The Company had working capital of \$2,282,744 and a current ratio of

1.9 at December 31, 1999 compared to working capital of \$3,471,715 and a current ratio of 2.4 at June 30, 1999.

There was no short or long-term debt outstanding at December 31, 1999 or June 30, 1999. The Company finalized a \$2,000,000 asset-based line of credit on November 22, 1999. There were no advances under this line of credit during the period from November 22, 1999 through December 31, 1999. As of January 31, 2000, the Company had total borrowings outstanding on the line of credit of \$180,021. Defaults by the Company on certain financial covenants as of November 30 and December 31, 1999 were waived by the bank in February 2000 and the line of credit agreement was amended to adjust specified levels of financial covenants 6.12 and 6.13 for the months ending January 31 and February 29, 2000.

Management believes that internally-generated cash flow and the new secured line of credit will be sufficient to support anticipated operating requirements during the remainder of fiscal 2000. Management is currently evaluating additional sources of capital that may be required to support 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.

IMPACT OF THE YEAR 2000 ISSUE

The Year 2000 ("Y2K") issue is the result of computer systems using a two-digit format, as opposed to four digits, to indicate the year. Such computer systems may be unable to interpret dates beyond the year 1999, which could cause a system failure or other computer errors, leading to disruptions in operations. A number of other date issues (e.g., incorrect handling of leap years) may also cause problems. All of these issues are collectively referred to as Y2K. In fiscal 1998, the Company developed a comprehensive program for Y2K compliance consisting of two parts: internal systems compliance and third party compliance. This program was described in the Company's Form 10-K for fiscal 1999 and Form 10-Q for the first quarter of fiscal 2000. All phases of the Y2K compliance program were completed prior to December 31, 1999.

The Company has not experienced any Y2K related problems with its internal systems nor has there been any disruption of supplies or services from third parties. However, because the Company's continued Y2K compliance in calendar 2000 is in part dependent on the continued Y2K compliance of third parties, there can be no assurance that the Company's efforts alone have resolved all Y2K issues or that key third parties will not experience Y2K compliance failures as calendar year 2000 progresses.

All costs for Y2K compliance have been expensed in the period incurred and have been paid from operating funds. The Company does not specifically track internal staff time spent on the Y2K issue, however, it has included an estimate of the cost of this time in the estimated total costs. The Company

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estimates the total costs for both the internal systems compliance program and the third party compliance program through December 31, 1999 were approximately \$25,000 and does not expect to incur additional costs.

Development of unforeseen Y2K complications and the Company's ability to deal with them continue to pose some risk and uncertainty which could result in, among other things, business disruption, operation problems, financial loss, legal liability and similar adverse consequences.

FORWARD-LOOKING STATEMENTS

From time to time, in reports filed with the Securities and Exchange Commission (including this Form 10-Q), 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, unforeseen Y2K complications and third party disruptions; and ability to satisfy funding requirements for operating needs, expansion or capital expenditures.

PART I - FINANCIAL INFORMATION

ITEM 3 - 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, precluding the need for foreign currency hedges. 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.

PART II

OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None.

Item 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Not applicable.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

The Regular Annual Meeting of Shareholders of the Company was held on November 11, 1999. The following matters were voted on by Shareholders:

1. The election of seven directors to serve on the Board of Directors for a term of one year and until their successors are duly elected and qualified.
2. The ratification of the appointment of Grant Thornton LLP as the Company's independent auditor for the Company's current fiscal year.

The results of the voting on these matters were as follows:

1. Board of Directors:

	For	Withhold Authority	Total
	-----	-----	-----
Lee M. Berlin	3,326,767	37,450	3,364,217
Alan C. Hymes, M.D.	3,315,769	48,448	3,364,217
Bert J. McKasy	3,326,767	37,450	3,364,217
Marilyn K. Speedie, Ph.D.	3,326,867	37,350	3,364,217
Donald C. Wegmiller	3,325,611	38,606	3,364,217
Rodney A. Young	3,319,604	44,613	3,364,217
Sheldon L. Zimble	3,326,867	37,350	3,364,217

2. Appointment of Grant Thornton LLP as independent auditor for the Company:

For	Against	Abstain	Non-Vote	Total
-----	-----	-----	-----	-----
3,324,142	8,220	31,855	--	3,364,217

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

Item No.	Item	Method of Filing
10.01	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	Filed herewith.
27	Financial data schedule	Filed herewith.

(b) REPORTS ON FORM 8-K

None.

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SIGNATURES

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

LECTEC CORPORATION

Date February 10, 2000

/s/ Rodney A. Young

Rodney A. Young, Chief Executive Officer & President

Date February 10, 2000

/s/ Deborah L. Moore

Deborah L. Moore, Chief Financial Officer

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CREDIT AND SECURITY AGREEMENT

BY AND BETWEEN

LECTEC CORPORATION

AND

WELLS FARGO BUSINESS CREDIT, INC.

Dated as of: November 22, 1999

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CREDIT AND SECURITY AGREEMENT

Dated as of November 22, 1999

LECTEC CORPORATION, a corporation (the "Borrower"), and WELLS FARGO BUSINESS CREDIT, INC., a Minnesota corporation (the "Lender"), hereby agree as follows:

ARTICLE I

Definitions

Section 1.1 Definitions. For all purposes of this Agreement, except as otherwise expressly provided or unless the context otherwise requires:

(a) the terms defined in this Article have the meanings assigned to them in this Article, and include the plural as well as the singular; and

(b) all accounting terms not otherwise defined herein have the meanings assigned to them in accordance with GAAP.

"Accounts" means all of the Borrower's accounts, as such term is defined in the UCC, including without limitation the aggregate unpaid obligations of customers and other account debtors to the Borrower arising out of the sale or lease of goods or rendition of services by the Borrower on an open account or deferred payment basis.

"Advance" means a Revolving Advance.

"Affiliate" or "Affiliates" means LecTec International Corporation, a corporation organized under the laws of the U.S. Virgin Islands, and any other Person controlled by, controlling or under common control with the Borrower, including (without limitation) any Subsidiary of the Borrower. For purposes of this definition, "control," when used with respect to any specified Person, means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise.

"Agreement" means this Credit and Security Agreement, as amended, supplemented or restated from time to time.

"Availability" means the difference of (i) the Borrowing Base and (ii) the sum of (A) the outstanding principal balance of the Revolving Note and (B) the L/C Amount.

"Banking Day" means a day other than a Saturday, Sunday or other day on which banks are generally not open for business in Minneapolis, Minnesota.

"Book Net Worth" means the aggregate of the common and preferred

stockholders' equity in the Borrower, determined in accordance with GAAP.

"Borrowing Base" means, at any time the lesser of:

- (a) the Maximum Line; or
- (b) subject to change from time to time in the Lender's sole discretion, the sum of:

- (i) 80% of Eligible Accounts, plus
- (ii) the lesser of (A) 50% of Eligible Finished Goods Inventory plus 25% of Eligible Raw Materials Inventory or (B) \$750,000; provided that the Inventory component of the Borrowing Base shall not exceed 33% of the Advances at any calendar month-end.

"Capital Expenditures" for a period means any expenditure of money for the lease, purchase or other acquisition of any capital asset, or for the lease of any other asset whether payable currently or in the future.

"Collateral" means all of the Borrower's Equipment, General Intangibles, Inventory, Receivables, Investment Property, all sums on deposit in any Collateral Account, and any items in any Lockbox; together with (i) all substitutions and replacements for and products of any of the foregoing; (ii) proceeds of any and all of the foregoing; (iii) in the case of all tangible goods, all accessions; (iv) all accessories, attachments, parts, equipment and repairs now or hereafter attached or affixed to or used in connection with any tangible goods; (v) all warehouse receipts, bills of lading and other documents of title now or hereafter covering such goods; and all sums on deposit in the Special Account.

"Collateral Account" has the meaning given in the Collateral Account Agreement.

"Collateral Account Agreement" means the Collateral Account Agreement of even date herewith by and among the Borrower, Norwest Bank Minnesota and the Lender.

"Commitment" means the Lender's commitment to make Advances and to cause the Issuer to issue Letters of Credit to or for the Borrower's account pursuant to Article II.

"Credit Facility" means the credit facility being made available to the Borrower by the Lender pursuant to Article II.

"Debt" of any Person means all items of indebtedness or liability which in accordance with GAAP would be included in determining total liabilities as shown on the liabilities side

of a balance sheet of that Person as at the date as of which Debt is to be determined. For purposes of determining a Person's aggregate Debt at any time, "Debt" shall also include the aggregate payments required to be made by such Person at any time under any lease that is considered a capitalized lease under GAAP.

"Default" means an event that, with giving of notice or passage of time or both, would constitute an Event of Default.

"Default Period" means any period of time beginning on the first day of any month during which a Default or Event of Default has occurred and ending on the date the Lender notifies the Borrower in writing that such Default or Event of Default has been cured or waived.

"Default Rate" means an annual rate equal to two percent (2%) over the Floating Rate, which rate shall change when and as the Floating Rate changes.

"ERISA" means the Employee Retirement Income Security Act of 1974,

as amended.

"Earnings Before Taxes" or "Loss Before Taxes" for a period means, pretax earnings or loss, as the case may be, from continuing operations before (i) special extraordinary gains, (ii) minority interests, and (iii) miscellaneous gains and losses, in each case for such period.

"Eligible Accounts" means all unpaid Accounts, net of any credits, except the following shall not in any event be deemed Eligible Accounts:

(i) That portion of Accounts unpaid 90 days or more after the invoice date or, if the Lender in its discretion has determined that a particular dated Account may be eligible, that portion of such Account which is unpaid more than 30 days past the stated due date or more than 120 days past the invoice date;

(ii) That portion of Accounts that is disputed or subject to a claim of offset or a contra account, including slotting fees or cooperative advertising;

(iii) That portion of Accounts not yet earned by the final delivery of goods or rendition of services, as applicable, by the Borrower to the customer;

(iv) Accounts owed by any unit of government, whether foreign or domestic (provided, however, that there shall be included in Eligible Accounts that portion of Accounts owed by such units of government for which the Borrower has provided evidence satisfactory to the Lender that (A) the Lender has a first priority perfected security interest and (B) such Accounts may be enforced by the Lender directly against such unit of government under all applicable laws);

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(v) Accounts owed by an account debtor located outside the United States or, at the Lender's discretion, Canada, which are not (A) backed by a bank letter of credit naming the Lender as beneficiary or assigned to the Lender, in the Lender's possession and acceptable to the Lender in all respects, in its sole discretion, (B) covered by a foreign receivables insurance policy acceptable to the Lender in its sole discretion;

(vi) Accounts owed by an account debtor that is insolvent, the subject of bankruptcy proceedings or has gone out of business;

(vii) Accounts owed by a shareholder, Subsidiary, Affiliate, officer or employee of the Borrower;

(viii) Accounts not subject to a duly perfected security interest in the Lender's favor or which are subject to any lien, security interest or claim in favor of any Person other than the Lender including without limitation any payment or performance bond;

(ix) That portion of Accounts that has been restructured, extended, amended or modified;

(x) That portion of Accounts that constitutes advertising, finance charges, service charges, sales or excise taxes or slotting fees due to retailers;

(xi) Accounts owed by an account debtor, regardless of whether otherwise eligible, if 10% or more of the total amount due under Accounts from such debtor is ineligible under clauses (i), (ii) or (ix) above; and

(xii) Accounts, or portions thereof, otherwise deemed ineligible by the Lender in its sole discretion.

"Eligible Finished Goods Inventory" means all Eligible Inventory of the Borrower consisting of finished goods.

"Eligible Inventory" means all Inventory of the Borrower, at the lower of cost or market value as determined in accordance with GAAP; provided, however, that the following shall not in any event be deemed Eligible Inventory:

(i) Inventory that is: in-transit; located at any warehouse, job site or other premises not approved by the Lender in writing; located outside of the states, or localities, as applicable, in which the Lender has filed financing statements to perfect a first priority security interest in such Inventory; covered by any negotiable or non-negotiable warehouse receipt, bill of lading or other document of title; on

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consignment from any Person; on consignment to any Person or subject to any bailment unless such consignee or bailee has executed an agreement with the Lender;

(ii) Supplies, packaging, parts or sample Inventory;

(iii) Work-in-process Inventory and material burden included in cost of Inventory;

(iv) Inventory that is damaged, obsolete or included in an obsolescence reserve, past its shelf-life expiration date, slow moving or not currently saleable in the normal course of the Borrower's operations;

(v) Inventory that the Borrower has returned, has attempted to return, is in the process of returning or intends to return to the vendor thereof;

(vi) Inventory that is perishable or live;

(vii) Inventory manufactured by the Borrower pursuant to a license unless the applicable licensor has agreed in writing to permit the Lender to exercise its rights and remedies against such Inventory;

(viii) Inventory that is subject to a security interest in favor of any Person other than the Lender; and

(ix) Inventory otherwise deemed ineligible by the Lender in its sole discretion.

"Eligible Raw Materials Inventory" means all Eligible Inventory of the Borrower consisting of raw materials.

"Environmental Laws" has the meaning specified in Section 5.12.

"Equipment" means all of the Borrower's equipment, as such term is defined in the UCC, whether now owned or hereafter acquired, including but not limited to all present and future machinery, vehicles, furniture, fixtures, manufacturing equipment, shop equipment, office and recordkeeping equipment, parts, tools, supplies, and including specifically (without limitation) the goods described in any equipment schedule or list herewith or hereafter furnished to the Lender by the Borrower.

"Event of Default" has the meaning specified in Section 8.1.

"Floating Rate" means an annual rate equal to the sum of the Prime Rate plus three percent (3%), which annual rate shall change when and as the Prime Rate changes.

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"Funding Date" has the meaning given in Section 2.1.

"GAAP" means generally accepted accounting principles, applied on a basis consistent with the accounting practices applied in the financial statements described in Section 5.5.

"Guarantor(s)" means any party who may hereafter deliver a guaranty (a "Guaranty") of the Obligations.

"General Intangibles" means all of the Borrower's general intangibles, as such term is defined in the UCC, whether now owned or hereafter acquired, including (without limitation) all present and future patents, patent applications, copyrights, trademarks, trade names, trade secrets, customer or supplier lists and contracts, manuals, operating instructions, permits, franchises, the right to use the Borrower's name, and the goodwill of the Borrower's business.

"Hazardous Substance" has the meaning given in Section 5.12.

"Inventory" means all of the Borrower's inventory, as such term is defined in the UCC, whether now owned or hereafter acquired, whether consisting of whole goods, spare parts or components, supplies or materials, whether acquired, held or furnished for sale, for lease or under service contracts or for manufacture or processing, and wherever located.

"Investment Property" means all of the Borrower's investment property, as such term is defined in the UCC, whether now owned or hereafter acquired, including but not limited to all securities, security entitlements, securities accounts, commodity contracts, commodity accounts, stocks, bonds, mutual fund shares, money market shares and U.S. Government securities.

"Issuer" means the issuer of any Letter of Credit.

"L/C Amount" means the sum of (i) the aggregate face amount of any issued and outstanding Letters of Credit and (ii) the unpaid amount of the Obligation of Reimbursement.

"L/C Application" means an application and agreement for letters of credit in a form acceptable to the Issuer and the Lender.

"Letter of Credit" has the meaning specified in Section 2.2.

"Loan Documents" means this Agreement, the Note and the Security Documents.

"Lockbox" has the meaning given in the Lockbox Agreement.

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"Lockbox Agreement" means the Lockbox Agreement by and among the Borrower, Norwest Bank Minnesota and, the Lender, of even date herewith.

"Maximum Line" means \$2,000,000, unless said amount is reduced pursuant to Section 2.10, in which event it means the amount to which said amount is reduced.

"Minimum Interest Charge" has the meaning given in Section 2.6(b).

"Net Income" means fiscal year-to-date after-tax net income, decreased by the sum of any extraordinary, non-operating or non-cash income recorded by the Borrower and increased by any extraordinary, non-cash or non-operating expense or loss recorded by the Borrower, as determined in accordance with GAAP.

"Norwest Bank Minnesota" means Norwest Bank Minnesota, National Association.

"Note" means the Revolving Note.

"Obligations" means the Note and each and every other debt, liability and obligation of every type and description which the Borrower may now or at any time hereafter owe to the Lender, whether such debt,

liability or obligation now exists or is hereafter created or incurred, whether it arises in a transaction involving the Lender alone or in a transaction involving other creditors of the Borrower, and whether it is direct or indirect, due or to become due, absolute or contingent, primary or secondary, liquidated or unliquidated, or sole, joint, several or joint and several, and including specifically, but not limited to, the Obligation of Reimbursement and all indebtedness of the Borrower arising under this Agreement, the Note, any L/C Application completed by the Borrower or any other loan or credit agreement or guaranty between the Borrower and the Lender, whether now in effect or hereafter entered into.

"Original Maturity Date" means November 22, 2001.

"Patent and Trademark Security Agreement" means the Patent and Trademark Security Agreement by the Borrower in favor of the Lender of even date herewith.

"Permitted Lien" has the meaning given in Section 7.1.

"Person" means any individual, corporation, partnership, joint venture, limited liability company, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision thereof.

"Plan" means an employee benefit plan or other plan maintained for the Borrower's employees and covered by Title IV of ERISA.

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"Premises" means all premises where the Borrower conducts its business and has any rights of possession, including (without limitation) the premises legally described on Exhibit C.

"Prime Rate" means the rate of interest publicly announced from time to time by Wells Fargo Bank, N.A. as its "prime rate" or, if such bank ceases to announce a rate so designated, any similar successor rate designated by the Lender.

"Receivables" means each and every right of the Borrower to the payment of money, whether such right to payment now exists or hereafter arises, whether such right to payment arises out of a sale, lease or other disposition of goods or other property, out of a rendering of services, out of a loan, out of the overpayment of taxes or other liabilities, or otherwise arises under any contract or agreement, whether such right to payment is created, generated or earned by the Borrower or by some other person who subsequently transfers such person's interest to the Borrower, whether such right to payment is or is not already earned by performance, and howsoever such right to payment may be evidenced, together with all other rights and interests (including all liens and security interests) which the Borrower may at any time have by law or agreement against any account debtor or other obligor obligated to make any such payment or against any property of such account debtor or other obligor; all including but not limited to all present and future accounts, contract rights, loans and obligations receivable, chattel papers, bonds, notes and other debt instruments, tax refunds and rights to payment in the nature of general intangibles.

"Reportable Event" shall have the meaning assigned to that term in Title IV of ERISA.

"Revolving Advance" has the meaning given in Section 2.1.

"Revolving Note" means the Borrower's revolving promissory note, payable to the order of the Lender in substantially the form of Exhibit A hereto, as the same may hereafter be amended, supplemented or restated from time to time, and any note or notes issued in substitution therefor, as the same may hereafter be amended, supplemented or restated from time to time and any note or notes issued in substitution therefor.

"Security Documents" means this Agreement, the Collateral Account Agreement, the Lockbox Agreement, the Patent and Trademark Security Agreement and any other document delivered to the Lender from time to time

to secure the Obligations, as the same may hereafter be amended, supplemented or restated from time to time.

"Security Interest" has the meaning given in Section 3.1.

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"Special Account" means a specified cash collateral account maintained by a financial institution acceptable to the Lender in connection with Letters of Credit, as contemplated by Section 2.4.

"Subordination Agreement" means any subordination agreement accepted by the Lender from time to time, as the same may hereafter be amended, supplemented or restated from time to time.

"Subsidiary" means any corporation of which more than 50% of the outstanding shares of capital stock having general voting power under ordinary circumstances to elect a majority of the board of directors of such corporation, irrespective of whether or not at the time stock of any other class or classes shall have or might have voting power by reason of the happening of any contingency, is at the time directly or indirectly owned by the Borrower, by the Borrower and one or more other Subsidiaries, or by one or more other Subsidiaries.

"Termination Date" means the earliest of (i) the Maturity Date, (ii) the date the Borrower terminates the Credit Facility, or (iii) the date the Lender demands payment of the Obligations after an Event of Default pursuant to Section 8.2.

"UCC" means the Uniform Commercial Code as in effect from time to time in the state designated in Section 9.14 as the state whose laws shall govern this Agreement, or in any other state whose laws are held to govern this Agreement or any portion hereof.

Section 1.2 Cross References. All references in this Agreement to Articles, Sections and subsections, shall be to Articles, Sections and subsections of this Agreement unless otherwise explicitly specified.

ARTICLE II

Amount and Terms of the Credit Facility

Section 2.1 Revolving Advances. The Lender agrees, on the terms and subject to the conditions herein set forth, to make advances to the Borrower from time to time from the date all of the conditions set forth in Section 4.1 are satisfied (the "Funding Date") to the Termination Date, on the terms and subject to the conditions herein set forth (the "Revolving Advances"). The Lender shall have no obligation to make a Revolving Advance if, after giving effect to such requested Revolving Advance, the sum of the outstanding and unpaid Revolving Advances under this Section 2.1 or otherwise would exceed the Borrowing Base less the L/C Amount. The Borrower's obligation to pay the Revolving Advances shall be evidenced by the Revolving Note and shall be secured by the Collateral as provided in Article III. Within the limits set forth in this Section 2.1, the Borrower may borrow, prepay pursuant to Section 2.10 and reborrow. The Borrower agrees to comply with the following procedures in requesting Revolving Advances under this Section 2.1:

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(a) The Borrower shall make each request for a Revolving Advance to the Lender before 11:00 a.m. (Minneapolis time) of the day of the requested Revolving Advance. Requests may be made in writing or by telephone, specifying the date of the requested Revolving Advance and the amount thereof. Each request shall be by (i) any officer of the Borrower; or (ii) any person designated as the Borrower's agent by any officer of the Borrower in a writing delivered to the Lender; or (iii) any person whom the Lender reasonably believes to be an officer of the Borrower or such a designated agent.

(b) Upon fulfillment of the applicable conditions set forth in

Article IV, the Lender shall disburse the proceeds of the requested Revolving Advance by crediting the same to the Borrower's demand deposit account maintained with Norwest Bank unless the Lender and the Borrower shall agree in writing to another manner of disbursement. Upon the Lender's request, the Borrower shall promptly confirm each telephonic request for an Advance by executing and delivering an appropriate confirmation certificate to the Lender. The Borrower shall repay all Advances even if the Lender does not receive such confirmation and even if the person requesting an Advance was not in fact authorized to do so. Any request for an Advance, whether written or telephonic, shall be deemed to be a representation by the Borrower that the conditions set forth in Section 4.2 have been satisfied as of the time of the request.

Section 2.2 Letters of Credit.

(a) The Lender agrees, on the terms and subject to the conditions herein set forth, to cause an Issuer to issue, from the Funding Date to the Termination Date, one or more irrevocable standby or documentary letters of credit (each, a "Letter of Credit") for the Borrower's account. The Lender shall have no obligation to cause an Issuer to issue any Letter of Credit if the face amount of the Letter of Credit to be issued would exceed the lessor of:

(i) \$250,000 less the L/C Amount, or

(ii) the Borrowing Base less the sum of (A) all outstanding and unpaid Revolving Advances and (B) the L/C Amount.

Each Letter of Credit, if any, shall be issued pursuant to a separate L/C Application entered into by the Borrower and the Lender for the benefit of the Issuer, completed in a manner satisfactory to the Lender and the Issuer. The terms and conditions set forth in each such L/C Application shall supplement the terms and conditions hereof, but if the terms of any such L/C Application and the terms of this Agreement are inconsistent, the terms hereof shall control.

(b) No Letter of Credit shall be issued with an expiry date later than the Termination Date in effect as of the date of issuance.

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(c) Any request to cause an Issuer to issue a Letter of Credit under this Section 2.2 shall be deemed to be a representation by the Borrower that the conditions set forth in Section 4.2 have been satisfied as of the date of the request.

Section 2.3 Payment of Amounts Drawn Under Letters of Credit; Obligation of Reimbursement.

The Borrower acknowledges that the Lender, as co-applicant, will be liable to the Issuer for reimbursement of any and all draws under Letters of Credit and for all other amounts required to be paid under the applicable L/C Application. Accordingly, the Borrower agrees to pay to the Lender any and all amounts required to be paid under the applicable L/C Application, when and as required to be paid thereby, and the amounts designated below, when and as designated:

(a) The Borrower hereby agrees to pay the Lender on the day a draft is honored under any Letter of Credit a sum equal to all amounts drawn under such Letter of Credit plus any and all reasonable charges and expenses that the Issuer or the Lender may pay or incur relative to such draw and the applicable L/C Application, plus interest on all such amounts, charges and expenses as set forth below (the Borrower's obligation to pay all such amounts is herein referred to as the "Obligation of Reimbursement").

(b) Whenever a draft is submitted under a Letter of Credit, the Lender shall make a Revolving Advance in the amount of the Obligation of Reimbursement and shall apply the proceeds of such Revolving Advance thereto. Such Revolving Advance shall be repayable in accordance with and be treated in all other respects as a Revolving Advance hereunder.

(c) If a draft is submitted under a Letter of Credit when the Borrower is unable, because a Default Period then exists or for any other reason, to obtain a Revolving Advance to pay the Obligation of Reimbursement, the Borrower shall pay to the Lender on demand and in immediately available funds, the amount of the Obligation of Reimbursement together with interest, accrued from the date of the draft until payment in full at the Default Rate. Notwithstanding the Borrower's inability to obtain a Revolving Advance for any reason, the Lender is irrevocably authorized, in its sole discretion, to make a Revolving Advance in an amount sufficient to discharge the Obligation of Reimbursement and all accrued but unpaid interest thereon.

(d) The Borrower's obligation to pay any Revolving Advance made under this Section 2.3, shall be evidenced by Revolving Note and shall bear interest as provided in Section 2.6.

Section 2.4 Special Account. If the Credit Facility is terminated for any reason whatsoever while any Letter of Credit is outstanding, the Borrower shall thereupon pay the Lender in immediately available funds for deposit in the Special Account an amount equal to the L/C Amount. The Special Account shall be an interest bearing account maintained for the Lender by any

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financial institution acceptable to the Lender. Any interest earned on amounts deposited in the Special Account shall be credited to the Special Account. Amounts on deposit in the Special Account may be applied by the Lender at any time or from time to time to the Obligations in the Lender's sole discretion, and shall not be subject to withdrawal by the Borrower so long as the Lender maintains a security interest therein. The Lender agrees to transfer any balance in the Special Account to the Borrower at such time as the Lender is required to release its security interest in the Special Account under applicable law.

Section 2.5 Obligations Absolute. The Borrower's obligations arising under Section 2.3 shall be absolute, unconditional and irrevocable, and shall be paid strictly in accordance with the terms of Section 2.3, under all circumstances whatsoever, including (without limitation) the following circumstances:

(a) any lack of validity or enforceability of any Letter of Credit or any other agreement or instrument relating to any Letter of Credit (collectively the "Related Documents");

(b) any amendment or waiver of or any consent to departure from all or any of the Related Documents;

(c) the existence of any claim, setoff, defense or other right which the Borrower may have at any time, against any beneficiary or any transferee of any Letter of Credit (or any persons or entities for whom any such beneficiary or any such transferee may be acting), or other person or entity, whether in connection with this Agreement, the transactions contemplated herein or in the Related Documents or any unrelated transactions;

(d) any statement or any other document presented under any Letter of Credit proving to be forged, fraudulent, invalid or insufficient in any respect or any statement therein being untrue or inaccurate in any respect whatsoever;

(e) payment by or on behalf of the Issuer or the Lender under any Letter of Credit against presentation of a draft or certificate which does not strictly comply with the terms of such Letter of Credit; or

(f) any other circumstance or happening whatsoever, whether or not similar to any of the foregoing.

Section 2.6 Interest; Minimum Interest Charge; Default Interest; Participations; Usury. Interest accruing on the Note shall be due and payable in arrears on the first day of each month.

(a) REVOLVING NOTE. Except as set forth in Sections 2.2(c) and 2.2(f), the outstanding principal balance of the Revolving Note shall bear

interest at the Floating Rate.

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(b) **MINIMUM INTEREST CHARGE.** Notwithstanding the interest payable pursuant to Section 2.2(a), the Borrower shall pay to the Lender interest of not less than the applicable amount shown below per year of this Agreement (the "Minimum Interest Charge") during the term of this Agreement, and the Borrower shall pay any deficiency between the Minimum Interest Charge and the amount of interest otherwise calculated under Sections 2.6(a) and 2.6(c) on the date and in the manner provided in Section 2.8:

Period -----	Minimum Annual Interest -----
Year One of Agreement	\$80,000
Year Two of Agreement and thereafter	\$95,000

(c) **DEFAULT INTEREST RATE.** At any time during any Default Period, in the Lender's sole discretion and without waiving any of its other rights and remedies, the principal of the Advances outstanding from time to time shall bear interest at the Default Rate, effective for any periods designated by the Lender from time to time during that Default Period.

(d) **PARTICIPATIONS.** If any Person shall acquire a participation in the Advances under this Agreement, the Borrower shall be obligated to the Lender to pay the full amount of all interest calculated under Section 2.6(a), along with all other fees, charges and other amounts due under this Agreement, regardless if such Person elects to accept interest with respect to its participation at a lower rate than the Floating Rate, or otherwise elects to accept less than its prorata share of such fees, charges and other amounts due under this Agreement.

(e) **USURY.** In any event no rate change shall be put into effect which would result in a rate greater than the highest rate permitted by law.

Section 2.7 Fees.

(a) **ORIGINATION FEE.** The Borrower hereby agrees to pay the Lender a fully earned and non-refundable origination fee of \$20,000 due and payable upon the execution of this Agreement. The Lender acknowledges receipt of \$8,500 toward payment of this fee and the fees, costs and expenses described in Sections 2.7(c) and 9.7.

(b) **UNUSED LINE FEE.** For the purposes of this Section 2.7(b), "Unused Amount" means the Maximum Line reduced by outstanding Revolving Advances plus the L/C Amount. The Borrower agrees to pay to the Lender an unused line fee at the rate of one-quarter of one percent (.25%) per annum on the average daily Unused Amount from the date of this Agreement to and including the Termination Date, due and payable monthly in arrears on the first day of the month and on the Termination Date.

(c) **LETTER OF CREDIT FEES.** The Borrower agrees to pay the Lender a fee with respect to each Letter of Credit, if any, accruing on a daily basis and computed at the annual

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rate of two percent (2%) of the aggregate amount that may then be drawn on all issued and outstanding Letters of Credit assuming compliance with all conditions for drawing thereunder (the "Aggregate Face Amount"), from and including the date of issuance of such Letter of Credit until such date as such Letter of Credit shall terminate by its terms or be returned to the Lender, due and payable monthly in arrears on the first day of each month and on the Termination Date; provided, however that during Default Periods, in the Lender's sole discretion and without waiving any of its other rights and remedies, such fee shall increase to four percent (4%) of the Aggregate Face Amount. The foregoing fee shall be in addition to any

and all fees, commissions and charges of any Issuer of a Letter of Credit with respect to or in connection with such Letter of Credit.

(d) **LETTER OF CREDIT ADMINISTRATIVE FEES.** The Borrower agrees to pay the Lender, on written demand, the administrative fees charged by the Issuer in connection with the honoring of drafts under any Letter of Credit, amendments thereto, transfers thereof and all other activity with respect to the Letters of Credit at the then-current rates published by the Issuer for such services rendered on behalf of customers of the Issuer generally.

(e) **AUDIT FEES.** The Borrower hereby agrees to pay the Lender, on demand, audit fees in connection with any audits or inspections conducted by the Lender of any Collateral or the Borrower's operations or business at the rates established from time to time by the Lender as its audit fees (which fees are currently \$62.50 per hour per auditor), together with all actual out-of-pocket costs and expenses incurred in conducting any such audit or inspection.

Section 2.8 Computation of Interest and Fees; When Interest Due and Payable. Interest accruing on the outstanding principal balance of the Advances and fees hereunder outstanding from time to time shall be computed on the basis of actual number of days elapsed in a year of 360 days. Interest shall be payable in arrears on the first day of each month and on the Termination Date, except that minimum interest pursuant to Section 2.6(b) shall be payable in arrears annually on each anniversary date and on the Termination Date.

Section 2.9 Capital Adequacy; Increased Costs and Reduced Return. If any Related Lender determines at any time that its Return has been reduced as a result of any Rule Change, such Related Lender may require the Borrower to pay it the amount necessary to restore its Return to what it would have been had there been no Rule Change. For purposes of this Section 2.5:

(a) "Capital Adequacy Rule" means any law, rule, regulation, guideline, directive, requirement or request regarding capital adequacy, or the interpretation or administration thereof by any governmental or regulatory authority, central bank or comparable agency, whether or not having the force of law, that applies to any Related Lender. Such rules include rules requiring financial institutions to maintain total capital in amounts based upon percentages of outstanding loans, binding loan commitments and letters of credit.

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(b) "L/C Rule" means any law, rule, regulation, guideline, directive, requirement or request regarding letters of credit, or the interpretation or administration thereof by any governmental or regulatory authority, central bank or comparable agency, whether or not having the force of law, that applies to any Related Lender. Such rules include rules imposing taxes, duties or other similar charges, or mandating reserves, special deposits or similar requirements against assets of, deposits with or for the account of, or credit extended by any Related Lender, on letters of credit.

(c) "Return", for any period, means the return as determined by such Related Lender on the Advances and Letters of Credit based upon its total capital requirements and a reasonable attribution formula that takes account of the Capital Adequacy Rules then in effect and costs of issuing or maintaining any Letter of Credit. Return may be calculated for each calendar quarter and for the shorter period between the end of a calendar quarter and the date of termination in whole of this Agreement.

(d) "Rule Change" means any change in any Capital Adequacy Rule or L/C Rule occurring after the date of this Agreement, but the term does not include any changes in applicable requirements that at the Closing Date are scheduled to take place under the existing Capital Adequacy Rules or L/C Rules or any increases in the capital that any Related Lender is required to maintain to the extent that the increases are required due to a regulatory authority's assessment of the financial condition of such Related Lender.

(e) "Related Lender" includes (but is not limited to) the Lender,

the Issuer, any parent corporation of the Lender or the Issuer and any assignee of any interest of the Lender hereunder and any participant in the loans made hereunder.

Certificates of any Related Lender sent to the Borrower from time to time claiming compensation under this Section 2.9, stating the reason therefor and setting forth in reasonable detail the calculation of the additional amount or amounts to be paid to the Related Lender hereunder to restore its Return shall be conclusive absent manifest error. In determining such amounts, the Related Lender may use any reasonable averaging and attribution methods.

Section 2.10 Voluntary Prepayment; Reduction of the Maximum Line; Termination of the Credit Facility by the Borrower; Automatic Renewal. Except as otherwise provided herein, the Borrower may prepay the Advances in whole at any time or from time to time in part. The Borrower may terminate the Credit Facility or reduce the Maximum Line at any time if it (i) gives the Lender at least 30 days' prior written notice and (ii) pays the Lender termination or line reduction fees in accordance with Section 2.11. Any reduction in the Maximum Line must be in an amount not less than \$100,000 or an integral multiple thereof. If the Borrower reduces the Maximum Line to zero, all Obligations shall be immediately due and payable. Upon termination of the Credit Facility and payment and performance of all Obligations, the Lender shall release or terminate the Security Interest and the Security Documents to which the Borrower is entitled by law. Unless terminated by the Lender at any time or by the Borrower pursuant to Section 2.11, the Credit Facility shall

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remain in effect until the Original Maturity Date and, thereafter, shall automatically renew for successive one year periods (the Original Maturity Date and each anniversary date thereof to which the Credit Facility has been automatically renewed, is herein referred to as a "Maturity Date").

Section 2.11 Termination and Line Reduction Fees; Waiver of Termination and Line Reduction Fees.

(a) TERMINATION AND LINE REDUCTION FEES. If the Credit Facility is terminated for any reason as of a date other than the Maturity Date, or the Borrower reduces the Maximum Line, the Borrower shall pay to the Lender a fee in an amount equal to a percentage of the Maximum Line (or the reduction, as the case may be) as follows: (A) two percent (2%) if the termination or reduction occurs on or before the first anniversary of the Funding Date and (B) one percent (1%) if the termination or reduction occurs after the first anniversary of the Funding Date.

(b) WAIVER OF TERMINATION AND LINE REDUCTION FEES. The Borrower will not be required to pay the termination or line reduction fees otherwise due under this Section 2.11 if such termination or line reduction is made because of cash flow generated from the Borrower's operations or refinancing by an affiliate of the Lender.

Section 2.12 Mandatory Prepayment. Without notice or demand, if the sum of the outstanding principal balance of the Revolving Advances plus the L/C Amount shall at any time exceed the Borrowing Base, the Borrower shall immediately prepay the Revolving Advances to the extent necessary to eliminate such excess; and (ii) if prepayment in full of the Revolving Advances is insufficient to eliminate such excess, pay the Lender in immediately available funds for deposit in the Special Account an amount equal to the remaining excess. Any payment received by the Lender under this Section 2.12 or under Section 2.10 may be applied to the Obligations, in such order and in such amounts as the Lender, in its discretion, may from time to time determine.

Section 2.13 Payment. All payments to the Lender shall be made in immediately available funds and shall be applied to the Obligations upon receipt by the Lender. The Lender may hold all payments not constituting immediately available funds for two (2) days before applying them to the Obligations. Notwithstanding anything in Section 2.1, the Borrower hereby authorizes the Lender, in its discretion at any time or from time to time without the Borrower's request and even if the conditions set forth in Section 4.2 would not be satisfied, to make a Revolving Advance in an amount equal to the portion of the Obligations from time to time due and payable.

Section 2.14 Payment on Non-Banking Days. Whenever any payment to be made hereunder shall be stated to be due on a day which is not a Banking Day, such payment may be made on the next succeeding Banking Day, and such extension of time shall in such case be included in the computation of interest on the Advances or the fees hereunder, as the case may be.

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Section 2.15 Use of Proceeds. The Borrower shall use the proceeds of Advances for ordinary working capital purposes.

Section 2.16 Liability Records. The Lender may maintain from time to time, at its discretion, liability records as to the Obligations. All entries made on any such record shall be presumed correct until the Borrower establishes the contrary. Upon the Lender's demand, the Borrower will admit and certify in writing the exact principal balance of the Obligations that the Borrower then asserts to be outstanding. Any billing statement or accounting rendered by the Lender shall be conclusive and fully binding on the Borrower unless the Borrower gives the Lender specific written notice of exception within 30 days after receipt.

ARTICLE III

Security Interest; Occupancy; Setoff

Section 3.1 Grant of Security Interest. The Borrower hereby pledges, assigns and grants to the Lender a security interest (collectively referred to as the "Security Interest") in the Collateral, as security for the payment and performance of the Obligations.

Section 3.2 Notification of Account Debtors and Other Obligors. The Lender may at any time (whether or not a Default Period then exists) notify any account debtor or other person obligated to pay the amount due that such right to payment has been assigned or transferred to the Lender for security and shall be paid directly to the Lender. The Borrower will join in giving such notice if the Lender so requests. At any time after the Borrower or the Lender gives such notice to an account debtor or other obligor, the Lender may, but need not, in the Lender's name or in the Borrower's name, (a) demand, sue for, collect or receive any money or property at any time payable or receivable on account of, or securing, any such right to payment, or grant any extension to, make any compromise or settlement with or otherwise agree to waive, modify, amend or change the obligations (including collateral obligations) of any such account debtor or other obligor; and (b) as the Borrower's agent and attorney-in-fact, notify the United States Postal Service to change the address for delivery of the Borrower's mail to any address designated by the Lender, otherwise intercept the Borrower's mail, and receive, open and dispose of the Borrower's mail, applying all Collateral as permitted under this Agreement and holding all other mail for the Borrower's account or forwarding such mail to the Borrower's last known address.

Section 3.3 Assignment of Insurance. As additional security for the payment and performance of the Obligations, the Borrower hereby assigns to the Lender any and all monies (including, without limitation, proceeds of insurance and refunds of unearned premiums) due or to become due under, and all other rights of the Borrower with respect to, any and all policies of insurance now or at any time hereafter covering the Collateral or any evidence thereof or any business records or valuable papers pertaining thereto, and the Borrower hereby directs the issuer of any such policy to pay all such monies directly to the Lender. At any time, whether or not a Default Period then exists, the Lender may (but need not), in the Lender's name or in the Borrower's

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name, execute and deliver proof of claim, receive all such monies, endorse checks and other instruments representing payment of such monies, and adjust, litigate, compromise or release any claim against the issuer of any such policy.

Section 3.4 Occupancy.

(a) The Borrower hereby irrevocably grants to the Lender the right

to take possession of the Premises at any time during a Default Period.

(b) The Lender may use the Premises only to hold, process, manufacture, sell, use, store, liquidate, realize upon or otherwise dispose of goods that are Collateral and for other purposes that the Lender may in good faith deem to be related or incidental purposes.

(c) The Lender's right to hold the Premises shall cease and terminate upon the earlier of (i) payment in full and discharge of all Obligations and termination of the Commitment, and (ii) final sale or disposition of all goods constituting Collateral and delivery of all such goods to purchasers.

(d) The Lender shall not be obligated to pay or account for any rent or other compensation for the possession, occupancy or use of any of the Premises; provided, however, that if the Lender does pay or account for any rent or other compensation for the possession, occupancy or use of any of the Premises, the Borrower shall reimburse the Lender promptly for the full amount thereof. In addition, the Borrower will pay, or reimburse the Lender for, all taxes, fees, duties, imposts, charges and expenses at any time incurred by or imposed upon the Lender by reason of the execution, delivery, existence, recordation, performance or enforcement of this Agreement or the provisions of this Section 3.4.

Section 3.5 License. Without limiting the generality of the Patent Security Agreement, Copyright Security Agreement, Trademark Security Agreement, the Borrower hereby grants to the Lender a non-exclusive, worldwide and royalty-free license to use or otherwise exploit all trademarks, franchises, trade names, copyrights and patents of the Borrower for the purpose of selling, leasing or otherwise disposing of any or all Collateral during any Default Period.

Section 3.6 Financing Statement. A carbon, photographic or other reproduction of this Agreement or of any financing statements signed by the Borrower is sufficient as a financing statement and may be filed as a financing statement in any state to perfect the security interests granted hereby. For this purpose, the following information is set forth:

Name and address of Debtor:

LecTec Corporation
10701 Red Circle Drive
Minnetonka, MN 55343

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Federal Tax Identification No. 41-1301878

Name and address of Secured Party:

Wells Fargo Business Credit, Inc.
Norwest Center, N9312-040
Sixth Street and Marquette Avenue
Minneapolis, Minnesota 55479
Federal Tax Identification No. 41-1237652

Section 3.7 Setoff. The Borrower agrees that the Lender may at any time or from time to time, at its sole discretion and without demand and without notice to anyone, setoff any liability owed to the Borrower by the Lender, whether or not due, against any Obligation, whether or not due. In addition, each other Person holding a participating interest in any Obligations shall have the right to appropriate or setoff any deposit or other liability then owed by such Person to the Borrower, whether or not due, and apply the same to the payment of said participating interest, as fully as if such Person had lent directly to the Borrower the amount of such participating interest.

ARTICLE IV

Conditions of Lending

Section 4.1 Conditions Precedent to the Initial Revolving Advance and the Initial Letter of Credit. The Lender's obligation to make the initial

Revolving Advance or to cause to be issued the initial Letter of Credit hereunder shall be subject to the condition precedent that the Lender shall have received all of the following, each in form and substance satisfactory to the Lender:

(a) This Agreement, properly executed by the Borrower.

(b) The Note, properly executed by the Borrower.

(c) A true and correct copy of any and all leases pursuant to which the Borrower is leasing the Premises, together with a landlord's disclaimer and consent with respect to each such lease.

(d) A true and correct copy of any and all agreements pursuant to which the Borrower's property is in the possession of any Person other than the Borrower, together with, in the case of any goods held by such Person for resale, (i) a consignee's acknowledgment and waiver of liens, (ii) UCC financing statements sufficient to protect the Borrower's and the Lender's interests in such goods, and (iii) UCC searches showing that no other secured party has filed a financing statement against such Person and covering property similar to the Borrower's other than the Borrower, or if there exists any such

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secured party, evidence that each such secured party has received notice from the Borrower and the Lender sufficient to protect the Borrower's and the Lender's interests in the Borrower's goods from any claim by such secured party.

(e) An acknowledgment and waiver of liens from each warehouse in which the Borrower is storing Inventory.

(f) A true and correct copy of any and all agreements pursuant to which the Borrower's property is in the possession of any Person other than the Borrower, together with, (i) an acknowledgment and waiver of liens from each subcontractor who has possession of the Borrower's goods from time to time, (ii) UCC financing statements sufficient to protect the Borrower's and the Lender's interests in such goods, and (iii) UCC searches showing that no other secured party has filed a financing statement covering such Person's property other than the Borrower, or if there exists any such secured party, evidence that each such secured party has received notice from the Borrower and the Lender sufficient to protect the Borrower's and the Lender's interests in the Borrower's goods from any claim by such secured party.

(g) Intentionally omitted.

(h) The Collateral Account Agreement, properly executed by the Borrower and Norwest Bank Minnesota.

(i) The Lockbox Agreement, properly executed by the Borrower and Norwest Bank Minnesota.

(j) The Patent and Trademark Security Agreement, properly executed by the Borrower.

(k) Current searches of appropriate filing offices showing that (i) no state or federal tax liens have been filed and remain in effect against the Borrower, (ii) no financing statements or assignments of patents, trademarks or copyrights have been filed and remain in effect against the Borrower except those financing statements and assignments of patents, trademarks or copyrights relating to Permitted Liens or to liens held by Persons who have agreed in writing that upon receipt of proceeds of the Advances, they will deliver UCC releases and/or terminations and releases of such assignments of patents, trademarks or copyrights satisfactory to the Lender, and (iii) the Lender has duly filed all financing statements necessary to perfect the Security Interest, to the extent the Security Interest is capable of being perfected by filing.

(l) A certificate of the Borrower's Secretary or Assistant Secretary certifying as to (i) the resolutions of the Borrower's directors and, if

required, shareholders, authorizing the execution, delivery and performance of the Loan Documents, (ii) the Borrower's articles

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of incorporation and bylaws, and (iii) the signatures of the Borrower's officers or agents authorized to execute and deliver the Loan Documents and other instruments, agreements and certificates, including Advance requests, on the Borrower's behalf.

(m) A current certificate issued by the Secretary of State of Minnesota, certifying that the Borrower is in compliance with all applicable organizational requirements of the State of Minnesota.

(n) Evidence that the Borrower is duly licensed or qualified to transact business in all jurisdictions where the character of the property owned or leased or the nature of the business transacted by it makes such licensing or qualification necessary.

(o) A certificate of an officer of the Borrower confirming, in his personal capacity, the representations and warranties set forth in Article V.

(p) An opinion of counsel to the Borrower, addressed to the Lender.

(q) Certificates of the insurance required hereunder, with all hazard insurance containing a lender's loss payable endorsement in the Lender's favor and with all liability insurance naming the Lender as an additional insured.

(r) Payment of the fees and commissions due through the date of the initial Advance or Letter of Credit under Section 2.7 and expenses incurred by the Lender through such date and required to be paid by the Borrower under Section 9.7, including all legal expenses incurred through the date of this Agreement.

(s) Such other documents as the Lender in its sole discretion may require.

Section 4.2 Conditions Precedent to All Advances and Letters of Credit. The Lender's obligation to make each Advance or to cause the Issuer to issue any Letter of Credit shall be subject to the further conditions precedent that on such date:

(a) the representations and warranties contained in Article V are correct on and as of the date of such Advance or issuance of Letter of Credit as though made on and as of such date, except to the extent that such representations and warranties relate solely to an earlier date; and

(b) no event has occurred and is continuing, or would result from such Advance or the issuance of such Letter of Credit, as the case may be, which constitutes a Default or an Event of Default.

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ARTICLE V

Representations and Warranties

The Borrower represents and warrants to the Lender as follows:

Section 5.1 Corporate Existence and Power; Name; Chief Executive Office; Inventory and Equipment Locations; Tax Identification Number. The Borrower is a corporation, duly organized, validly existing and in good standing under the laws of the State of Minnesota and is duly licensed or qualified to transact business in all jurisdictions where the character of the property owned or leased or the nature of the business transacted by it makes such licensing or qualification necessary. The Borrower has all requisite power and authority, corporate or otherwise, to conduct its business, to own its properties and to execute and deliver, and to perform all of its obligations under, the Loan

Documents. During its existence, the Borrower has done business solely under the names set forth in Schedule 5.1 hereto. The Borrower's chief executive office and principal place of business is located at the address set forth in Schedule 5.1 hereto, and all of the Borrower's records relating to its business or the Collateral are kept at that location. All Inventory and Equipment is located at that location or at one of the other locations set forth in Schedule 5.1 hereto. The Borrower's tax identification number is correctly set forth in Section 3.6 hereto.

Section 5.2 Authorization of Borrowing; No Conflict as to Law or Agreements. The execution, delivery and performance by the Borrower of the Loan Documents and the borrowings from time to time hereunder have been duly authorized by all necessary corporate action and do not and will not (i) require any consent or approval of the Borrower's stockholders; (ii) require any authorization, consent or approval by, or registration, declaration or filing with, or notice to, any governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, or any third party, except such authorization, consent, approval, registration, declaration, filing or notice as has been obtained, accomplished or given prior to the date hereof; (iii) violate any provision of any law, rule or regulation (including, without limitation, Regulation X of the Board of Governors of the Federal Reserve System) or of any order, writ, injunction or decree presently in effect having applicability to the Borrower or of the Borrower's articles of incorporation or bylaws; (iv) result in a breach of or constitute a default under any indenture or loan or credit agreement or any other material agreement, lease or instrument to which the Borrower is a party or by which it or its properties may be bound or affected; or (v) result in, or require, the creation or imposition of any mortgage, deed of trust, pledge, lien, security interest or other charge or encumbrance of any nature (other than the Security Interest) upon or with respect to any of the properties now owned or hereafter acquired by the Borrower.

Section 5.3 Legal Agreements. This Agreement constitutes and, upon due execution by the Borrower, the other Loan Documents will constitute the legal, valid and binding obligations of the Borrower, enforceable against the Borrower in accordance with their respective terms, except as enforceability may be limited by applicable bankruptcy, insolvency, fraudulent conveyance,

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reorganization, moratorium or similar laws affecting the enforcement of creditors rights generally, and by general equitable principles.

Section 5.4 Subsidiaries. Except as set forth in Schedule 5.4, the Borrower has no Subsidiaries.

Section 5.5 Financial Condition; No Adverse Change. The Borrower has heretofore furnished to the Lender audited financial statements of the Borrower for its fiscal year ended June 30, 1999 and unaudited financial statements of the Borrower for the fiscal year-to-date period ended September 30, 1999, and those statements fairly present the Borrower's financial condition on the dates thereof and the results of its operations and cash flows for the periods then ended and were prepared in accordance with generally accepted accounting principles. Since the date of the most recent financial statements, there has been no material adverse change in the Borrower's business, properties or condition (financial or otherwise).

Section 5.6 Litigation. There are no actions, suits or proceedings pending or, to the Borrower's knowledge, threatened against or affecting the Borrower or any of its Affiliates or the properties of the Borrower or any of its Affiliates before any court or governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, which, if determined adversely to the Borrower or any of its Affiliates, would have a material adverse effect on the financial condition, properties or operations of the Borrower or any of its Affiliates.

Section 5.7 Regulation U. The Borrower is not engaged in the business of extending credit for the purpose of purchasing or carrying margin stock (within the meaning of Regulation U of the Board of Governors of the Federal Reserve System), and no part of the proceeds of any Advance will be used to purchase or carry any margin stock or to extend credit to others for the purpose of purchasing or carrying any margin stock.

Section 5.8 Taxes. The Borrower and its Affiliates have paid or caused to be paid to the proper authorities when due all federal, state and local taxes required to be withheld by each of them. The Borrower and its Affiliates have filed all federal, state and local tax returns which to the knowledge of the officers of the Borrower or any Affiliate, as the case may be, are required to be filed, and the Borrower and its Affiliates have paid or caused to be paid to the respective taxing authorities all taxes as shown on said returns or on any assessment received by any of them to the extent such taxes have become due.

Section 5.9 Titles and Liens. The Borrower has good and absolute title to all Collateral described in the collateral reports provided to the Lender and all other Collateral, properties and assets reflected in the latest financial statements referred to in Section 5.5 and all proceeds thereof, free and clear of all mortgages, security interests, liens and encumbrances, except for Permitted Liens. No financing statement naming the Borrower as debtor is on file in any office except to perfect only Permitted Liens.

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Section 5.10 Plans. Except as disclosed to the Lender in writing prior to the date hereof, neither the Borrower nor any of its Affiliates maintains or has maintained any Plan. Neither the Borrower nor any Affiliate has received any notice or has any knowledge to the effect that it is not in full compliance with any of the requirements of ERISA. No Reportable Event or other fact or circumstance which may have an adverse effect on the Plan's tax qualified status exists in connection with any Plan. Neither the Borrower nor any of its Affiliates has:

(a) Any accumulated funding deficiency within the meaning of ERISA;
or

(b) Any liability or knows of any fact or circumstances which could result in any liability to the Pension Benefit Guaranty Corporation, the Internal Revenue Service, the Department of Labor or any participant in connection with any Plan (other than accrued benefits which or which may become payable to participants or beneficiaries of any such Plan).

Section 5.11 Default. The Borrower is in compliance with all provisions of all agreements, instruments, decrees and orders to which it is a party or by which it or its property is bound or affected, the breach or default of which could have a material adverse effect on the Borrower's financial condition, properties or operations.

Section 5.12 Environmental Matters.

(a) Definitions. As used in this Agreement, the following terms shall have the following meanings:

(i) "Environmental Law" means any federal, state, local or other governmental statute, regulation, law or ordinance dealing with the protection of human health and the environment.

(ii) "Hazardous Substances" means pollutants, contaminants, hazardous substances, hazardous wastes, petroleum and fractions thereof, and all other chemicals, wastes, substances and materials listed in, regulated by or identified in any Environmental Law.

(b) To the Borrower's best knowledge, there are not present in, on or under the Premises any Hazardous Substances in such form or quantity as to create any liability or obligation for either the Borrower or the Lender under common law of any jurisdiction or under any Environmental Law, and no Hazardous Substances have ever been stored, buried, spilled, leaked, discharged, emitted or released in, on or under the Premises in such a way as to create any such liability.

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(c) To the Borrower's best knowledge, the Borrower has not disposed

of Hazardous Substances in such a manner as to create any liability under any Environmental Law.

(d) There are not and there never have been any requests, claims, notices, investigations, demands, administrative proceedings, hearings or litigation, relating in any way to the Premises or the Borrower, alleging liability under, violation of, or noncompliance with any Environmental Law or any license, permit or other authorization issued pursuant thereto. To the Borrower's best knowledge, no such matter is threatened or impending.

(e) To the Borrower's best knowledge, the Borrower's businesses are and have in the past always been conducted in accordance with all Environmental Laws and all licenses, permits and other authorizations required pursuant to any Environmental Law and necessary for the lawful and efficient operation of such businesses are in the Borrower's possession and are in full force and effect. No permit required under any Environmental Law is scheduled to expire within 12 months and there is no threat that any such permit will be withdrawn, terminated, limited or materially changed.

(f) To the Borrower's best knowledge, the Premises are not and never have been listed on the National Priorities List, the Comprehensive Environmental Response, Compensation and Liability Information System or any similar federal, state or local list, schedule, log, inventory or database.

(g) The Borrower has delivered to Lender all environmental assessments, audits, reports, permits, licenses and other documents describing or relating in any way to the Premises or Borrower's businesses.

Section 5.13 Submissions to Lender. All financial and other information provided to the Lender by or on behalf of the Borrower in connection with the Borrower's request for the credit facilities contemplated hereby is true and correct in all material respects and, as to projections, valuations or proforma financial statements, present a good faith opinion as to such projections, valuations and proforma condition and results.

Section 5.14 Financing Statements. The Borrower has provided to the Lender signed financing statements sufficient when filed to perfect the Security Interest and the other security interests created by the Security Documents. When such financing statements are filed in the offices noted therein, the Lender will have a valid and perfected security interest in all Collateral and all other collateral described in the Security Documents which is capable of being perfected by filing financing statements. None of the Collateral or other collateral covered by the Security Documents is or will become a fixture on real estate, unless a sufficient fixture filing is in effect with respect thereto.

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Section 5.15 Rights to Payment. Each right to payment and each instrument, document, chattel paper and other agreement constituting or evidencing Collateral or other collateral covered by the Security Documents is (or, in the case of all future Collateral or such other collateral, will be when arising or issued) the valid, genuine and legally enforceable obligation, subject to no defense, setoff or counterclaim, of the account debtor or other obligor named therein or in the Borrower's records pertaining thereto as being obligated to pay such obligation.

ARTICLE VI

Borrower's Affirmative Covenants

So long as the Obligations shall remain unpaid, or the Credit Facility shall remain outstanding, the Borrower will comply with the following requirements, unless the Lender shall otherwise consent in writing:

Section 6.1 Reporting Requirements. The Borrower will deliver, or cause to be delivered, to the Lender each of the following, which shall be in form and detail acceptable to the Lender:

(a) as soon as available, and in any event within 120 days after the

end of each fiscal year of the Borrower, the Borrower's audited financial statements with the unqualified opinion of independent certified public accountants selected by the Borrower and acceptable to the Lender, which annual financial statements shall include the Borrower's balance sheet as at the end of such fiscal year and the related statements of the Borrower's income, retained earnings and cash flows for the fiscal year then ended, prepared, if the Lender so requests, on a consolidating and consolidated basis to include any Affiliates, all in reasonable detail and prepared in accordance with GAAP, together with (i) copies of all management letters prepared by such accountants; (ii) a report signed by such accountants stating that in making the investigations necessary for said opinion they obtained no knowledge, except as specifically stated, of any Default or Event of Default hereunder and all relevant facts in reasonable detail to evidence, and the computations as to, whether or not the Borrower is in compliance with the requirements set forth in Sections 6.12, 6.13 and 7.10; and (iii) a certificate of the Borrower's chief financial officer stating that such financial statements have been prepared in accordance with GAAP and whether or not such officer has knowledge of the occurrence of any Default or Event of Default hereunder and, if so, stating in reasonable detail the facts with respect thereto;

(b) as soon as available and in any event within 30 days after the end of each month, an unaudited/internal balance sheet and statements of income and retained earnings of the Borrower as at the end of and for such month and for the year to date period then ended, prepared, if the Lender so requests, on a consolidating and consolidated basis to include any Affiliates, in reasonable detail and stating in comparative form the figures for

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the corresponding date and periods in the previous year, all prepared in accordance with GAAP, subject to year-end audit adjustments; and accompanied by a certificate of the Borrower's chief financial officer, substantially in the form of Exhibit B hereto stating (i) that such financial statements have been prepared in accordance with GAAP, subject to year-end audit adjustments, (ii) whether or not such officer has knowledge of the occurrence of any Default or Event of Default hereunder not theretofore reported and remedied and, if so, stating in reasonable detail the facts with respect thereto, and (iii) all relevant facts in reasonable detail to evidence, and the computations as to, whether or not the Borrower is in compliance with the requirements set forth in Sections 6.12, 6.13 and 7.10;

(c) within 25 days after the end of each month or more frequently if the Lender so requires, agings of the Borrower's accounts receivable and its accounts payable, an inventory certification report, and a calculation of the Borrower's Accounts, Eligible Accounts, Inventory and Eligible Inventory as at the end of such month or shorter time period;

(d) at least 30 days after the beginning of each fiscal year of the Borrower, the projected balance sheets and income statements for each month of such year, each in reasonable detail, representing the Borrower's good faith projections and certified by the Borrower's chief financial officer as being the most accurate projections available and identical to the projections used by the Borrower for internal planning purposes, together with such supporting schedules and information as the Lender may in its discretion require;

(e) immediately after the commencement thereof, notice in writing of all litigation and of all proceedings before any governmental or regulatory agency affecting the Borrower of the type described in Section 5.12 or which seek a monetary recovery against the Borrower in excess of \$50,000;

(f) as promptly as practicable (but in any event not later than five business days) after an officer of the Borrower obtains knowledge of the occurrence of any breach, default or event of default under any Security Document or any event which constitutes a Default or Event of Default hereunder, notice of such occurrence, together with a detailed statement by a responsible officer of the Borrower of the steps being taken by the Borrower to cure the effect of such breach, default or event;

(g) as soon as possible and in any event within 30 days after the Borrower knows or has reason to know that any Reportable Event with respect to any Plan has occurred, the statement of the Borrower's chief financial officer setting forth details as to such Reportable Event and the action which the Borrower proposes to take with respect thereto, together with a copy of the notice of such Reportable Event to the Pension Benefit Guaranty Corporation;

(h) as soon as possible, and in any event within 10 days after the Borrower fails to make any quarterly contribution required with respect to any Plan under Section 412(m)

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of the Internal Revenue Code of 1986, as amended, the statement of the Borrower's chief financial officer setting forth details as to such failure and the action which the Borrower proposes to take with respect thereto, together with a copy of any notice of such failure required to be provided to the Pension Benefit Guaranty Corporation;

(i) promptly upon knowledge thereof, notice of (A) any of the following items exceeding \$50,000 individually (i) any disputes or claims by the Borrower's customers; (ii) credit memos; (iii) any goods returned to or recovered by the Borrower; and (B) any change in the persons constituting the Borrower's officers and directors;

(j) promptly upon knowledge thereof, notice of any loss of or material damage to any Collateral or other collateral covered by the Security Documents or of any substantial adverse change in any Collateral or such other collateral or the prospect of payment thereof;

(k) promptly upon their distribution, copies of all financial statements, reports and proxy statements which the Borrower shall have sent to its stockholders;

(l) promptly after the sending or filing thereof, copies of all regular and periodic reports which the Borrower shall file with the Securities and Exchange Commission or any national securities exchange;

(m) promptly upon knowledge thereof, notice of the Borrower's violation of any law, rule or regulation, the non-compliance with which could materially and adversely affect the Borrower's business or its financial condition; and

(n) from time to time, with reasonable promptness, any and all receivables schedules, collection reports, deposit records, equipment schedules, copies of invoices to account debtors, shipment documents and delivery receipts for goods sold, and such other material, reports, records or information as the Lender may request.

Section 6.2 Books and Records; Inspection and Examination. The Borrower will keep accurate books of record and account for itself pertaining to the Collateral and pertaining to the Borrower's business and financial condition and such other matters as the Lender may from time to time request in which true and complete entries will be made in accordance with GAAP and, upon the Lender's request, will permit any officer, employee, attorney or accountant for the Lender to audit, review, make extracts from or copy any and all corporate and financial books and records of the Borrower at all times during ordinary business hours, to send and discuss with account debtors and other obligors requests for verification of amounts owed to the Borrower, and to discuss the Borrower's affairs with any of its directors, officers, employees or agents. The Borrower will permit the Lender, or its employees, accountants, attorneys or agents, to examine and inspect any Collateral, other collateral covered by the Security Documents or any other property of the Borrower at any time during ordinary business hours.

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Section 6.3 Account Verification. The Lender may at any time and

from time to time send or require the Borrower to send requests for verification of accounts or notices of assignment to account debtors and other obligors. The Lender may also at any time and from time to time telephone account debtors and other obligors to verify accounts.

Section 6.4 Compliance with Laws.

(a) The Borrower will (i) comply with the requirements of applicable laws and regulations, the non-compliance with which would materially and adversely affect its business or its financial condition and (ii) use and keep the Collateral, and require that others use and keep the Collateral, only for lawful purposes, without violation of any federal, state or local law, statute or ordinance.

(b) Without limiting the foregoing undertakings, the Borrower specifically agrees that it will comply with all applicable Environmental Laws and obtain and comply with all permits, licenses and similar approvals required by any Environmental Laws, and will not generate, use, transport, treat, store or dispose of any Hazardous Substances in such a manner as to create any liability or obligation under the common law of any jurisdiction or any Environmental Law.

Section 6.5 Payment of Taxes and Other Claims. The Borrower will pay or discharge, when due, (a) all taxes, assessments and governmental charges levied or imposed upon it or upon its income or profits, upon any properties belonging to it (including, without limitation, the Collateral) or upon or against the creation, perfection or continuance of the Security Interest, prior to the date on which penalties attach thereto, (b) all federal, state and local taxes required to be withheld by it, and (c) all lawful claims for labor, materials and supplies which, if unpaid, might by law become a lien or charge upon any properties of the Borrower; provided, that the Borrower shall not be required to pay any such tax, assessment, charge or claim whose amount, applicability or validity is being contested in good faith by appropriate proceedings and for which proper reserves have been made.

Section 6.6 Maintenance of Properties.

(a) The Borrower will keep and maintain the Collateral, the other collateral covered by the Security Documents and all of its other properties necessary or useful in its business in good condition, repair and working order (normal wear and tear excepted) and will from time to time replace or repair any worn, defective or broken parts; provided, however, that nothing in this Section 6.6 shall prevent the Borrower from discontinuing the operation and maintenance of any of its properties if such discontinuance is, in the Lender's judgment, desirable in the conduct of the Borrower's business and not disadvantageous in any material respect to the Lender.

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(b) The Borrower will defend the Collateral against all claims or demands of all persons (other than the Lender) claiming the Collateral or any interest therein.

(c) The Borrower will keep all Collateral and other collateral covered by the Security Documents free and clear of all security interests, liens and encumbrances except Permitted Liens.

Section 6.7 Insurance. The Borrower will obtain and at all times maintain insurance with insurers believed by the Borrower to be responsible and reputable, in such amounts and against such risks as may from time to time be required by the Lender, but in all events in such amounts and against such risks as is usually carried by companies engaged in similar business and owning similar properties in the same general areas in which the Borrower operates. Without limiting the generality of the foregoing, the Borrower will at all times keep all tangible Collateral insured against risks of fire (including so-called extended coverage), theft, collision (for Collateral consisting of motor vehicles) and such other risks and in such amounts as the Lender may reasonably request, with any loss payable to the Lender to the extent of its interest, and all policies of such insurance shall contain a lender's loss payable endorsement for the Lender's benefit acceptable to the Lender. All policies of liability insurance required hereunder shall name the Lender as an additional insured.

Section 6.8 Preservation of Existence. The Borrower will preserve and maintain its existence and all of its rights, privileges and franchises necessary or desirable in the normal conduct of its business and shall conduct its business in an orderly, efficient and regular manner.

Section 6.9 Delivery of Instruments, etc. Upon request by the Lender, the Borrower will promptly deliver to the Lender in pledge all instruments, documents and chattel papers constituting Collateral, duly endorsed or assigned by the Borrower.

Section 6.10 Collateral Account.

(a) If, notwithstanding the instructions to debtors to make payments to the Lockbox, the Borrower receives any payments on Receivables, the Borrower shall deposit such payments into the Collateral Account. Until so deposited, the Borrower shall hold all such payments in trust for and as the property of the Lender and shall not commingle such payments with any of its other funds or property.

(b) Amounts deposited in the Collateral Account shall not bear interest and shall not be subject to withdrawal by the Borrower, except after full payment and discharge of all Obligations.

(c) All deposits in the Collateral Account shall constitute proceeds of Collateral and shall not constitute payment of the Obligations. The Lender from time to time at its discretion may, after allowing two (2) Banking Days, apply deposited funds in the Collateral

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Account to the payment of the Obligations, in any order or manner of application satisfactory to the Lender, by transferring such funds to the Lender's general account.

(d) All items deposited in the Collateral Account shall be subject to final payment. If any such item is returned uncollected, the Borrower will immediately pay the Lender, or, for items deposited in the Collateral Account, the bank maintaining such account, the amount of that item, or such bank at its discretion may charge any uncollected item to the Borrower's commercial account or other account. The Borrower shall be liable as an endorser on all items deposited in the Collateral Account, whether or not in fact endorsed by the Borrower.

Section 6.11 Performance by the Lender. If the Borrower at any time fails to perform or observe any of the foregoing covenants contained in this Article VI or elsewhere herein, and if such failure shall continue for a period of ten calendar days after the Lender gives the Borrower written notice thereof (or in the case of the agreements contained in Sections 6.5, 6.7 and 6.10, immediately upon the occurrence of such failure, without notice or lapse of time), the Lender may, but need not, perform or observe such covenant on behalf and in the name, place and stead of the Borrower (or, at the Lender's option, in the Lender's name) and may, but need not, take any and all other actions which the Lender may reasonably deem necessary to cure or correct such failure (including, without limitation, the payment of taxes, the satisfaction of security interests, liens or encumbrances, the performance of obligations owed to account debtors or other obligors, the procurement and maintenance of insurance, the execution of assignments, security agreements and financing statements, and the endorsement of instruments); and the Borrower shall thereupon pay to the Lender on demand the amount of all monies expended and all costs and expenses (including reasonable attorneys' fees and legal expenses) incurred by the Lender in connection with or as a result of the performance or observance of such agreements or the taking of such action by the Lender, together with interest thereon from the date expended or incurred at the Floating Rate. To facilitate the Lender's performance or observance of such covenants of the Borrower, the Borrower hereby irrevocably appoints the Lender, or the Lender's delegate, acting alone, as the Borrower's attorney in fact (which appointment is coupled with an interest) with the right (but not the duty) from time to time to create, prepare, complete, execute, deliver, endorse or file in the name and on behalf of the Borrower any and all instruments, documents, assignments, security agreements, financing statements, applications for insurance and other agreements and writings required to be obtained,

executed, delivered or endorsed by the Borrower under this Section 6.11.

Section 6.12 Minimum Book Net Worth. The Borrower will maintain, during each period described below, its Book Net Worth, determined as at the end of each month, at an amount not less than the amount set forth opposite such period:

Period Ended -----	Minimum Book Net Worth -----
November 30, 1999	\$6,378,000
December 31, 1999	\$6,128,000
January 31, 2000	\$5,778,000

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Period Ended -----	Minimum Book Net Worth -----
February 29, 2000	\$5,528,000
March 31, 2000	\$5,428,000
April 30, 2000	\$5,178,000
May 31, 2000	\$4,978,000
June 30, 2000	\$4,808,000

Section 6.13 Minimum Earnings/Maximum Loss Before Taxes. The Borrower will achieve during each period described below, year-to-date Earnings or Loss Before Taxes, of not less than/greater than the amount set forth opposite such period (bracketed amounts indicate maximum Loss Before Taxes):

Period Ended -----	Minimum Earnings/Maximum Loss Before Taxes -----
November 30, 1999	(\$1,130,000)
December 31, 1999	(\$1,380,000)
January 31, 2000	(\$1,730,000)
February 29, 2000	(\$1,980,000)
March 31, 2000	(\$2,080,000)
April 30, 2000	(\$2,330,000)
May 31, 2000	(\$2,530,000)
June 30, 2000	(\$2,700,000)

Section 6.14 New Covenants. On or before July 31, 2000, The Borrower and the Lender shall agree on new covenant levels for Sections 6.13, 6.14 and 7.10 for periods after such date. The new covenant levels will be based on the Borrower's projections for such periods and shall be no less stringent than the present levels.

ARTICLE VII

Negative Covenants

So long as the Obligations shall remain unpaid, or the Credit Facility shall remain outstanding, the Borrower agrees that, without the Lender's prior written consent:

Section 7.1 Liens. The Borrower will not create, incur or suffer to exist any mortgage, deed of trust, pledge, lien, security interest, assignment or transfer upon or of any of its assets, now owned or hereafter acquired, to secure any indebtedness; excluding, however, from the operation of the foregoing, the following (collectively, "Permitted Liens"):

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(a) in the case of any of the Borrower's property which is not Collateral or other collateral described in the Security Documents, covenants, restrictions, rights, easements and minor irregularities in title which do not materially interfere with the Borrower's business or operations as presently conducted, provided, however, that the Borrower expressly agrees that it will not mortgage its real estate locally known as 10701 Red Circle Drive, Minnetonka, Minnesota;

(b) mortgages, deeds of trust, pledges, liens, security interests and assignments in existence on the date hereof and listed in Schedule 7.1 hereto, securing indebtedness for borrowed money permitted under Section 7.2;

(c) the Security Interest and liens and security interests created by the Security Documents;

(d) purchase money security interests relating to the acquisition of machinery and equipment of the Borrower not exceeding the lower of cost or fair market value thereof and so long as no Default Period is then in existence and none would exist immediately after such acquisition;

(e) liens of carriers, warehousemen, mechanics and materialmen, and other like liens arising in the ordinary course of business for sums not due;

(f) deposits or pledges, or liens incurred, to secure payment of worker's compensation, unemployment insurance, old age pension or other social security obligations, in the ordinary course of business of the Borrower;

(g) liens incurred or deposits or pledges made or given in connection with or to secure payment of indemnity, performance or other similar bonds;

(h) liens for taxes, fees, assessments and governmental charges not delinquent or to the extent that payment therefor shall not at the time be required if the same are being contested in good faith by appropriate proceedings, and adequate reserves with respect thereto have been set aside on the Borrower's books in accordance with GAAP;

(i) banker's liens, rights of setoff and similar liens incurred on deposits made in the ordinary course of business; and

(j) judgment, attachment or similar liens, unless the judgment it secures has not been discharged or execution thereof effectively stayed and bonded against pending appeal with 30 days after the entry thereof.

Section 7.2 Indebtedness. The Borrower will not incur, create, assume or permit to exist any indebtedness or liability on account of deposits or advances or any indebtedness for

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borrowed money or letters of credit issued on the Borrower's behalf, or any other indebtedness or liability evidenced by notes, bonds, debentures or similar obligations, except:

(a) indebtedness arising hereunder;

(b) indebtedness of the Borrower in existence on the date hereof and listed in Schedule 7.2 hereto; and

(c) indebtedness relating to liens permitted in accordance with Section 7.1.

Section 7.3 Guaranties. The Borrower will not assume, guarantee, endorse or otherwise become directly or contingently liable in connection with any obligations of any other Person, except:

(a) the endorsement of negotiable instruments by the Borrower for deposit or collection or similar transactions in the ordinary course of business; and

(b) guaranties, endorsements and other direct or contingent liabilities in connection with the obligations of other Persons, in existence on the date hereof and listed in Schedule 7.2 hereto.

Section 7.4 Investments and Subsidiaries.

(a) The Borrower will not purchase or hold beneficially any stock or other securities or evidences of indebtedness of, make or permit to exist any loans or advances to, or make any investment or acquire any interest whatsoever in, any other Person, including specifically but without limitation any partnership or joint venture, except:

(i) investments in direct obligations of the United States of America or any agency or instrumentality thereof whose obligations constitute full faith and credit obligations of the United States of America having a maturity of one year or less, commercial paper issued by U.S. corporations rated "A-1" or "A-2" by Standard & Poors Corporation or "P-1" or "P-2" by Moody's Investors Service or certificates of deposit or bankers' acceptances having a maturity of one year or less issued by members of the Federal Reserve System having deposits in excess of \$100,000,000 (which certificates of deposit or bankers' acceptances are fully insured by the Federal Deposit Insurance Corporation);

(ii) travel advances or loans to the Borrower's officers and employees not exceeding at any one time an aggregate of \$25,000; and

(iii) advances in the form of progress payments, prepaid rent not exceeding three months or security deposits.

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(b) The Borrower will not create or permit to exist any new Subsidiary.

Section 7.5 Dividends. Except as set forth below, the Borrower will not declare or pay any dividends (other than dividends payable solely in stock of the Borrower) on any class of its stock or make any payment on account of the purchase, redemption or other retirement of any shares of such stock or make any distribution in respect thereof, either directly or indirectly.

Section 7.6 Sale or Transfer of Assets; Suspension of Business Operations. The Borrower will not sell, lease, assign, transfer or otherwise dispose of (i) the stock of any Subsidiary, (ii) all or a substantial part of its assets, or (iii) any Collateral or any interest therein (whether in one transaction or in a series of transactions) to any other Person other than the sale of Inventory in the ordinary course of business and will not liquidate, dissolve or suspend business operations. The Borrower will not in any manner transfer any property without prior or present receipt of full and adequate consideration.

Section 7.7 Consolidation and Merger; Asset Acquisitions. The Borrower will not consolidate with or merge into any Person, or permit any other Person to merge into it, or acquire (in a transaction analogous in purpose or effect to a consolidation or merger) all or substantially all the assets of any other Person.

Section 7.8 Sale and Leaseback. The Borrower will not enter into any arrangement, directly or indirectly, with any other Person whereby the Borrower shall sell or transfer any real or personal property, whether now owned or hereafter acquired, and then or thereafter rent or lease as lessee such property or any part thereof or any other property which the Borrower intends to use for substantially the same purpose or purposes as the property being sold or transferred.

Section 7.9 Restrictions on Nature of Business. The Borrower will not engage in any line of business materially different from that presently engaged in by the Borrower and will not purchase, lease or otherwise acquire assets not related to its business.

Section 7.10 Capital Expenditures. The Borrower will not incur or contract to incur Capital Expenditures of more than \$600,000 in the aggregate during any fiscal year, or more than \$250,000 in any one transaction.

Section 7.11 Accounting. The Borrower will not adopt any material change in accounting principles other than as required by GAAP. The Borrower will not adopt, permit or consent to any change in its fiscal year.

Section 7.12 Discounts, etc. The Borrower will not, after notice from the Lender, grant any discount, credit or allowance to any customer of the Borrower or accept any return of goods sold, or at any time (whether before or after notice from the Lender) modify, amend, subordinate, cancel or terminate the obligation of any account debtor or other obligor of the Borrower.

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Section 7.13 Defined Benefit Pension Plans. The Borrower will not adopt, create, assume or become a party to any defined benefit pension plan, unless disclosed to the Lender pursuant to Section 5.10.

Section 7.14 Other Defaults. The Borrower will not permit any breach, default or event of default to occur under any note, loan agreement, indenture, lease, mortgage, contract for deed, security agreement or other contractual obligation binding upon the Borrower.

Section 7.15 Place of Business; Name. The Borrower will not transfer its chief executive office or principal place of business, or move, relocate, close or sell any business location. The Borrower will not permit any tangible Collateral or any records pertaining to the Collateral to be located in any state or area in which, in the event of such location, a financing statement covering such Collateral would be required to be, but has not in fact been, filed in order to perfect the Security Interest. The Borrower will not change its name.

Section 7.16 Organizational Documents; S Corporation Status. The Borrower will not amend its certificate of incorporation, articles of incorporation or bylaws. The Borrower will not become an S Corporation.

Section 7.17 Salaries. The Borrower will not pay excessive or unreasonable salaries, bonuses, commissions, consultant fees or other compensation; or increase the salary, bonus, commissions, consultant fees or other compensation of any director, officer or consultant, or any member of their families, by more than 15% in any one year, either individually or for all such persons in the aggregate, or pay any such increase from any source other than profits earned in the year of payment.

ARTICLE VIII

Events of Default, Rights and Remedies

Section 8.1 Events of Default. "Event of Default", wherever used herein, means any one of the following events:

(a) Default in the payment of the Obligations when they become due and payable;

(b) Failure to pay when due any amount specified in Section 2.3 relating to the Borrower's Obligation of Reimbursement, or failure to pay immediately when due or upon termination of the Credit Facility any amounts required to be paid for deposit in the Special Account under Section 2.4;

(c) Default in the payment of any fees, commissions, costs or expenses required to be paid by the Borrower under this Agreement;

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(d) Default in the performance, or breach, of any covenant or agreement of the Borrower contained in this Agreement;

(e) The Borrower or any Guarantor shall be or become insolvent, or admit in writing its or his inability to pay its or his debts as they mature, or make an assignment for the benefit of creditors; or the Borrower or any Guarantor shall apply for or consent to the appointment of any receiver, trustee, or similar officer for it or him or for all or any substantial part of its or his property; or such receiver, trustee or similar officer shall be appointed without the application or consent of the Borrower or such Guarantor, as the case may be; or the Borrower or any

Guarantor shall institute (by petition, application, answer, consent or otherwise) any bankruptcy, insolvency, reorganization, arrangement, readjustment of debt, dissolution, liquidation or similar proceeding relating to it or him under the laws of any jurisdiction; or any such proceeding shall be instituted (by petition, application or otherwise) against the Borrower or any such Guarantor; or any judgment, writ, warrant of attachment or execution or similar process shall be issued or levied against a substantial part of the property of the Borrower or any Guarantor;

(f) A petition shall be filed by or against the Borrower or any Guarantor under the United States Bankruptcy Code naming the Borrower or such Guarantor as debtor;

(g) Any material representation or warranty made by the Borrower in this Agreement, by any Guarantor in any guaranty delivered to the Lender, or by the Borrower (or any of its officers) or any Guarantor in any agreement, certificate, instrument or financial statement or other statement contemplated by or made or delivered pursuant to or in connection with this Agreement or any such guaranty shall prove to have been incorrect in any material respect when deemed to be effective;

(h) The rendering against the Borrower of a final judgment, decree or order for the payment of money in excess of \$75,000 and the continuance of such judgment, decree or order unsatisfied and in effect for any period of 30 consecutive days without a stay of execution;

(i) A default under any bond, debenture, note or other evidence of indebtedness of the Borrower owed to any Person other than the Lender, or under any indenture or other instrument under which any such evidence of indebtedness has been issued or by which it is governed, or under any lease of any of the Premises, and the expiration of the applicable period of grace, if any, specified in such evidence of indebtedness, indenture, other instrument or lease;

(j) Any Reportable Event, which the Lender determines in good faith might constitute grounds for the termination of any Plan or for the appointment by the appropriate United States District Court of a trustee to administer any Plan, shall have occurred and be continuing 30 days after written notice to such effect shall have been given to the Borrower

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by the Lender; or a trustee shall have been appointed by an appropriate United States District Court to administer any Plan; or the Pension Benefit Guaranty Corporation shall have instituted proceedings to terminate any Plan or to appoint a trustee to administer any Plan; or the Borrower shall have filed for a distress termination of any Plan under Title IV of ERISA; or the Borrower shall have failed to make any quarterly contribution required with respect to any Plan under Section 412(m) of the Internal Revenue Code of 1986, as amended, which the Lender determines in good faith may by itself, or in combination with any such failures that the Lender may determine are likely to occur in the future, result in the imposition of a lien on the Borrower's assets in favor of the Plan;

(k) An event of default shall occur under any Security Document or under any other security agreement, mortgage, deed of trust, assignment or other instrument or agreement securing any obligations of the Borrower hereunder or under any note;

(l) The Borrower shall liquidate, dissolve, terminate or suspend its business operations or otherwise fail to operate its business in the ordinary course, or sell all or substantially all of its assets, without the Lender's prior written consent;

(m) The Borrower shall fail to pay, withhold, collect or remit any tax or tax deficiency when assessed or due (other than any tax deficiency which is being contested in good faith and by proper proceedings and for which it shall have set aside on its books adequate reserves therefor) or notice of any state or federal tax liens shall be filed or issued;

(n) Default in the payment of any amount owed by the Borrower to the

Lender other than any indebtedness arising hereunder;

(o) Any Guarantor shall repudiate, purport to revoke or fail to perform any such Guarantor's obligations under such guarantor's guaranty in favor of the Lender, any individual Guarantor shall die or any other Guarantor shall cease to exist;

(p) The Borrower shall take or participate in any action which would be prohibited under the provisions of any Subordination Agreement or make any payment on the Subordinated Indebtedness (as defined in the Subordination Agreement) that any Person was not entitled to receive under the provisions of the Subordination Agreement;

(q) Any breach, default or event of default by or attributable to any Affiliate under any agreement between such Affiliate and the Lender.

Section 8.2 Rights and Remedies. During any Default Period, the Lender may exercise any or all of the following rights and remedies:

(a) the Lender may, by notice to the Borrower, declare the Commitment to be terminated, whereupon the same shall forthwith terminate;

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(b) the Lender may, by notice to the Borrower, declare the Obligations to be forthwith due and payable, whereupon all Obligations shall become and be forthwith due and payable, without presentment, notice of dishonor, protest or further notice of any kind, all of which the Borrower hereby expressly waives;

(c) the Lender may, without notice to the Borrower and without further action, apply any and all money owing by the Lender to the Borrower to the payment of the Obligations;

(d) the Lender may make demand upon the Borrower and, forthwith upon such demand, the Borrower will pay to the Lender in immediately available funds for deposit in the Special Account pursuant to Section 2.4 an amount equal to the aggregate maximum amount available to be drawn under all Letters of Credit then outstanding, assuming compliance with all conditions for drawing thereunder;

(e) the Lender may exercise and enforce any and all rights and remedies available upon default to a secured party under the UCC, including, without limitation, the right to take possession of Collateral, or any evidence thereof, proceeding without judicial process or by judicial process (without a prior hearing or notice thereof, which the Borrower hereby expressly waives) and the right to sell, lease or otherwise dispose of any or all of the Collateral, and, in connection therewith, the Borrower will on demand assemble the Collateral and make it available to the Lender at a place to be designated by the Lender which is reasonably convenient to both parties;

(f) the Lender may exercise and enforce its rights and remedies under the Loan Documents; and

(g) the Lender may exercise any other rights and remedies available to it by law or agreement.

Notwithstanding the foregoing, upon the occurrence of an Event of Default described in subsections (e) or (f) of Section 8.1, the Obligations shall be immediately due and payable automatically without presentment, demand, protest or notice of any kind.

Section 8.3 Certain Notices. If notice to the Borrower of any intended disposition of Collateral or any other intended action is required by law in a particular instance, such notice shall be deemed commercially reasonable if given (in the manner specified in Section 9.3) at least ten calendar days before the date of intended disposition or other action.

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ARTICLE IX

Miscellaneous

Section 9.1 No Waiver; Cumulative Remedies. No failure or delay by the Lender in exercising any right, power or remedy under the Loan Documents shall operate as a waiver thereof; nor shall any single or partial exercise of any such right, power or remedy preclude any other or further exercise thereof or the exercise of any other right, power or remedy under the Loan Documents. The remedies provided in the Loan Documents are cumulative and not exclusive of any remedies provided by law.

Section 9.2 Amendments, Etc. No amendment, modification, termination or waiver of any provision of any Loan Document or consent to any departure by the Borrower therefrom or any release of a Security Interest shall be effective unless the same shall be in writing and signed by the Lender, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given. No notice to or demand on the Borrower in any case shall entitle the Borrower to any other or further notice or demand in similar or other circumstances.

Section 9.3 Addresses for Notices, Etc. Except as otherwise expressly provided herein, all notices, requests, demands and other communications provided for under the Loan Documents shall be in writing and shall be (a) personally delivered, (b) sent by first class United States mail, (c) sent by overnight courier of national reputation, or (d) transmitted by telecopy, in each case addressed or telecopied to the party to whom notice is being given at its address or telecopier number as set forth below:

If to the Borrower:

LecTec Corporation
10701 Red Circle Drive
Minnetonka, MN 55343
Telecopier: (612) 933-4808
Attention: Rodney A. Young

If to the Lender:

Wells Fargo Business Credit, Inc.
Norwest Center, N9312-040
Sixth Street and Marquette Avenue
Minneapolis, Minnesota 55479
Telecopier: 612/341-2472
Attention: Diane G. Conley

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or, as to each party, at such other address or telecopier number as may hereafter be designated by such party in a written notice to the other party complying as to delivery with the terms of this Section. All such notices, requests, demands and other communications shall be deemed to have been given on (a) the date received if personally delivered, (b) when deposited in the mail if delivered by mail, (c) the date sent if sent by overnight courier, or (d) the date of transmission if delivered by telecopy, except that notices or requests to the Lender pursuant to any of the provisions of Article II shall not be effective until received by the Lender.

Section 9.4 Further Documents. The Borrower will from time to time execute and deliver or endorse any and all instruments, documents, conveyances, assignments, security agreements, financing statements and other agreements and writings that the Lender may reasonably request in order to secure, protect, perfect or enforce the Security Interest or the Lender's rights under the Loan Documents (but any failure to request or assure that the Borrower executes, delivers or endorses any such item shall not affect or impair the validity, sufficiency or enforceability of the Loan Documents and the Security Interest, regardless of whether any such item was or was not executed, delivered or endorsed in a similar context or on a prior occasion).

Section 9.5 Collateral. This Agreement does not contemplate a sale of accounts, contract rights or chattel paper, and, as provided by law, the

Borrower is entitled to any surplus and shall remain liable for any deficiency. The Lender's duty of care with respect to Collateral in its possession (as imposed by law) shall be deemed fulfilled if it exercises reasonable care in physically keeping such Collateral, or in the case of Collateral in the custody or possession of a bailee or other third person, exercises reasonable care in the selection of the bailee or other third person, and the Lender need not otherwise preserve, protect, insure or care for any Collateral. The Lender shall not be obligated to preserve any rights the Borrower may have against prior parties, to realize on the Collateral at all or in any particular manner or order or to apply any cash proceeds of the Collateral in any particular order of application.

Section 9.6 Costs and Expenses. The Borrower agrees to pay on demand all costs and expenses, including (without limitation) reasonable attorneys' fees, incurred by the Lender in connection with the Obligations, this Agreement, the Loan Documents, any Letters of Credit, and any other document or agreement related hereto or thereto, and the transactions contemplated hereby, including without limitation all such costs, expenses and fees incurred in connection with the negotiation, preparation, execution, amendment, administration, performance, collection and enforcement of the Obligations and all such documents and agreements and the creation, perfection, protection, satisfaction, foreclosure or enforcement of the Security Interest.

Section 9.7 Indemnity. In addition to the payment of expenses pursuant to Section 9.7, the Borrower agrees to indemnify, defend and hold harmless the Lender, and any of its participants, parent corporations, subsidiary corporations, affiliated corporations, successor corporations, and all present and future officers, directors, employees, attorneys and agents of the foregoing (the "Indemnitees") from and against any of the following (collectively, "Indemnified Liabilities"):

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(i) any and all transfer taxes, documentary taxes, assessments or charges made by any governmental authority by reason of the execution and delivery of the Loan Documents or the making of the Advances;

(ii) any claims, loss or damage to which any Indemnatee may be subjected if any representation or warranty contained in Section 5.12 proves to be incorrect in any respect or as a result of any violation of the covenant contained in Section 6.4(b); and

(iii) any and all other liabilities, losses, damages, penalties, judgments, suits, claims, costs and expenses of any kind or nature whatsoever (including, without limitation, the reasonable fees and disbursements of counsel) in connection with the foregoing and any other investigative, administrative or judicial proceedings, whether or not such Indemnatee shall be designated a party thereto, which may be imposed on, incurred by or asserted against any such Indemnatee, in any manner related to or arising out of or in connection with the making of the Advances and the Loan Documents or the use or intended use of the proceeds of the Advances.

If any investigative, judicial or administrative proceeding arising from any of the foregoing is brought against any Indemnatee, upon such Indemnatee's request, the Borrower, or counsel designated by the Borrower and satisfactory to the Indemnatee, will resist and defend such action, suit or proceeding to the extent and in the manner directed by the Indemnatee, at the Borrower's sole costs and expense. Each Indemnatee will use its best efforts to cooperate in the defense of any such action, suit or proceeding. If the foregoing undertaking to indemnify, defend and hold harmless may be held to be unenforceable because it violates any law or public policy, the Borrower shall nevertheless make the maximum contribution to the payment and satisfaction of each of the Indemnified Liabilities which is permissible under applicable law. The Borrower's obligation under this Section 9.7 shall survive the termination of this Agreement and the discharge of the Borrower's other obligations hereunder.

An Indemnatee seeking indemnification under this Section 9.7 will notify the Borrower of any event requiring indemnification within a reasonable amount of time following such Indemnatee's receipt of notice of commencement of any action or proceeding, or such Indemnatee's obtaining knowledge of the occurrence

of any other event, giving rise to a claim for indemnification hereunder. The Borrower will be entitled (but not obligated) to assume the defense or settlement of any such action or proceeding or to participate in any negotiations to settle or otherwise resolve any claim using counsel of its choice; provided that such counsel is reasonably satisfactory to such Indemnitee. If the Borrower elects to assume the defense or settlement of any such action or proceeding, such Indemnitee (and its counsel) may continue to participate at its own expense in such action or proceeding.

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Section 9.8 Participants. The Lender and its participants, if any, are not partners or joint venturers, and the Lender shall not have any liability or responsibility for any obligation, act or omission of any of its participants. All rights and powers specifically conferred upon the Lender may be transferred or delegated to any of the Lender's participants, successors or assigns.

Section 9.9 Execution in Counterparts. This Agreement and other Loan Documents may be executed in any number of counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which counterparts, taken together, shall constitute but one and the same instrument.

Section 9.10 Binding Effect; Assignment; Complete Agreement; Exchanging Information. The Loan Documents shall be binding upon and inure to the benefit of the Borrower and the Lender and their respective successors and assigns, except that the Borrower shall not have the right to assign its rights thereunder or any interest therein without the Lender's prior written consent. This Agreement, together with the Loan Documents, comprises the complete and integrated agreement of the parties on the subject matter hereof and supersedes all prior agreements, written or oral, on the subject matter hereof. Without limiting the Lender's right to share information regarding the Borrower and its Affiliates with the Lender's participants, accountants, lawyers and other advisors, the Lender, Wells Fargo Corporation, and all direct and indirect subsidiaries of Wells Fargo Corporation, may exchange any and all information they may have in their possession regarding the Borrower and its Affiliates, and the Borrower waives any right of confidentiality it may have with respect to such exchange of such information.

Section 9.11 Severability of Provisions. Any provision of this Agreement which is prohibited or unenforceable shall be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof.

Section 9.12 Headings. Article and Section headings in this Agreement are included herein for convenience of reference only and shall not constitute a part of this Agreement for any other purpose.

Section 9.13 Governing Law; Jurisdiction, Venue; Waiver of Jury Trial. The Loan Documents shall be governed by and construed in accordance with the substantive laws (other than conflict laws) of the State of Minnesota. This Agreement shall be governed by and construed in accordance with the substantive laws (other than conflict laws) of the State of Minnesota. The parties hereto hereby (i) consents to the personal jurisdiction of the state and federal courts located in the State of Minnesota in connection with any controversy related to this Agreement; (ii) waives any argument that venue in any such forum is not convenient, (iii) agrees that any litigation initiated by the Lender or the Borrower in connection with this Agreement or the other Loan Documents shall be venued in either the District Court of Hennepin County, Minnesota, or the United States District Court, District of Minnesota, Fourth Division; and (iv) agrees that a final judgment in any such suit, action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the

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judgment or in any other manner provided by law. THE PARTIES WAIVE ANY RIGHT TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING BASED ON OR PERTAINING TO THIS AGREEMENT.

Section 9.14 Confidentiality. The Lender agrees to exercise due care

to maintain the confidentiality of all information relating to the Borrower which has been provided to the Lender, and neither the Lender nor any of its affiliates shall use any such information for any purpose in any manner other than pursuant to the terms contemplated by the Loan Documents, except to the extent such information (a) was or becomes generally available to the public, other than as result of a disclosure by the Lender, or (b) was or becomes available on a nonconfidential basis from a source other than the Borrower, provided that such source is not bound by a confidentiality agreement with the Borrower that is known to the Lender; provided further, however, that the Lender may disclose such information (i) at the request of or pursuant to any requirement of any governmental authority to which the Lender is subject to or in connection with the examination of the Lender by any such authority, (ii) pursuant to a subpoena or other court process; (iii) when required to do so in accordance with the provisions of any applicable law, (iv) to the Lender's independent auditors and other professional advisors, and (v) to any person or entity and in any proceeding necessary in the Lender's reasonable judgment to protect the Lender's interest in connection with any claim or dispute involving the Lender. The Borrower authorizes the Lender to disclose to any prospective transferee such financial and other information in the Lender's possession, provided that, prior to such disclosure, such prospective transferee agrees in writing to be bound by the provisions of this Section 9.14.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective officers thereunto duly authorized as of the date first above written.

WELLS FARGO BUSINESS CREDIT, INC.

LECTEC CORPORATION

By /s/ Diane G. Conley

By /s/ Deborah L. Moore

Diane G. Conley
An Officer

Deborah L. Moore
Its Chief Financial Officer

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Exhibit A to Credit and Security Agreement

REVOLVING NOTE

\$2,000,000.00

Minneapolis, Minnesota
November 22, 1999

For value received, the undersigned, LECTEC CORPORATION, a Minnesota corporation (the "Borrower"), hereby promises to pay on the Termination Date under the Credit Agreement (defined below), to the order of WELLS FARGO BUSINESS CREDIT, INC., a Minnesota corporation (the "Lender"), at its main office in Minneapolis, Minnesota, or at any other place designated at any time by the

holder hereof, in lawful money of the United States of America and in immediately available funds, the principal sum of Two Million and 00/100 Dollars (\$2,000,000.00) or, if less, the aggregate unpaid principal amount of all Revolving Advances made by the Lender to the Borrower under the Credit Agreement (defined below) together with interest on the principal amount hereunder remaining unpaid from time to time, computed on the basis of the actual number of days elapsed and a 360-day year, from the date hereof until this Note is fully paid at the rate from time to time in effect under the Credit and Security Agreement of even date herewith (as the same may hereafter be amended, supplemented or restated from time to time, the "Credit Agreement") by and between the Lender and the Borrower. The principal hereof and interest accruing thereon shall be due and payable as provided in the Credit Agreement. This Note may be prepaid only in accordance with the Credit Agreement.

This Note is issued pursuant, and is subject, to the Credit Agreement, which provides, among other things, for acceleration hereof. This Note is the Revolving Note referred to in the Credit Agreement. This Note is secured, among other things, pursuant to the Credit Agreement and the Security Documents as therein defined, and may now or hereafter be secured by one or more other security agreements, mortgages, deeds of trust, assignments or other instruments or agreements.

The Borrower hereby agrees to pay all costs of collection, including attorneys' fees and legal expenses in the event this Note is not paid when due, whether or not legal proceedings are commenced.

Presentment or other demand for payment, notice of dishonor and protest are expressly waived.

LECTEC CORPORATION

By

Deborah L. Moore
Its Chief Financial Officer

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Exhibit B to Credit and Security Agreement

COMPLIANCE CERTIFICATE

To: Diane G. Conley
Wells Fargo Business Credit, Inc.

Date: _____, _____

Subject: LecTec Corporation
Financial Statements

In accordance with our Credit and Security Agreement dated as of November 22, 1999 (the "Credit Agreement"), attached are the financial statements of LecTec Corporation (the "Borrower") as of and for _____, _____ (the "Reporting Date") and the year-to-date period then ended (the "Current Financials"). All terms used in this certificate have the meanings given in the Credit Agreement.

I certify that the Current Financials have been prepared in accordance with GAAP, subject to year-end audit adjustments, and fairly present the Borrower's financial condition and the results of its operations as of the date thereof.

Events of Default. (Check one):

- [] The undersigned does not have knowledge of the occurrence of a Default or Event of Default under the Credit Agreement.
- [] The undersigned has knowledge of the occurrence of a Default or Event of Default under the Credit Agreement and attached hereto is a statement of the facts with respect to thereto.

I hereby certify to the Lender as follows:

Financial Covenants. I further hereby certify as follows:

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1. Minimum Book Net Worth. Pursuant to Section 6.12 of the Credit Agreement, as of the Reporting Date, the Borrower's Book Net Worth was \$_____ which ☐ satisfies ☐ does not satisfy the requirement that such amount be not less than \$_____ on the Reporting Date[as set forth in table below:

Period -----	Minimum Book Net Worth -----
November 30, 1999	\$6,378,000
December 31, 1999	\$6,128,000
January 31, 2000	\$5,778,000
February 29, 2000	\$5,528,000
March 31, 2000	\$5,428,000
April 30, 2000	\$5,178,000
May 31, 2000	\$4,978,000
June 30, 2000	\$4,808,000

2. Minimum Earnings/Maximum Loss Before Taxes. Pursuant to Section 6.13 of the Credit Agreement, the Borrower's Earnings/Loss Before Taxes for the period ending on the Reporting Date, was \$_____, which ☐ satisfies ☐ does not satisfy the requirement that such amount be not less than/greater than \$_____ during such period as set forth in table below (bracketed amounts indicate maximum Loss Before Taxes):

Period Ending -----	Minimum Earnings Before Taxes -----
November 30, 1999	(\$1,130,000)
December 31, 1999	(\$1,380,000)
January 31, 2000	(\$1,730,000)
February 29, 2000	(\$1,980,000)
March 31, 2000	(\$2,080,000)
April 30, 2000	(\$2,330,000)
May 31, 2000	(\$2,530,000)
June 30, 2000	(\$2,700,000)

3. Capital Expenditures. Pursuant to Section 7.10 of the Credit Agreement, for the year-to-date period ending on the Reporting Date, the Borrower has expended or contracted to expend during the fiscal year ended _____, _____, for Capital Expenditures, \$_____ in the aggregate and at most \$_____ in any one transaction, which ☐ satisfies ☐ does not satisfy the requirement that such expenditures not exceed \$600,000 in the aggregate and \$250,000 for any one transaction during such year.

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4. Salaries. As of the Reporting Date, the Borrower ☐ is ☐ is not in compliance with Section 7.17 of the Credit Agreement concerning salaries.

Attached hereto are all relevant facts in reasonable detail to evidence, and the computations of the financial covenants referred to above. These computations were made in accordance with GAAP.

LECTEC CORPORATION

By

Deborah L. Moore
Its Chief Financial Officer

Exhibit C to Credit and Security Agreement

PREMISES

The Premises referred to in the Credit and Security Agreement are legally described as follows:

Lot 2, Block 11, Opus 2, Fourth Addition, Hennepin County, Minnesota

AND

Lot 1, Block 1, Edina Interchange Center, Fifth Addition, Hennepin County, Minnesota

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Schedule 5.1 to Credit and Security Agreement

Trade Names, Chief Executive Office, Principal Place of Business, and Locations of Collateral

TRADE NAMES

NONE

CHIEF EXECUTIVE OFFICE/PRINCIPAL PLACE OF BUSINESS

10701 Red Circle Drive
Minnetonka, MN 55343

OTHER INVENTORY AND EQUIPMENT LOCATIONS

7401 Cahill Road, Edina MN
38 Hope Street, Niantic, CT
6090 White Hart Lane, Mississauga, Ontario, Canada
725-B-22nd Avenue, Honolulu, HI
Hwy. 56 and I-26, Clinton, SC
1060 Clyde Drive, Hammond, WI
220 East Marie Ave., West St. Paul, Minnesota
490 Vandenberg Street, Baldwin, WI
1284 Corporate Center Drive #150, Eagan, MN
1903 N. Oxford Ave., Eau Claire, WI

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Schedule 7.1 to Credit and Security Agreement

PERMITTED LIENS

Creditor	Collateral	Jurisdiction	Filing Date	Filing No.
Loffler	Specific Equipment	MN Sec. of State	3/30/98	2023866
Bankvest	Specific Equipment	MN Sec. of State	4/6/99	2119892
Capital Corp.				

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Schedule 7.2 to Credit and Security Agreement

PERMITTED INDEBTEDNESS AND GUARANTIES

Indebtedness

NONE

Guaranties

NONE

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FIRST AMENDMENT TO CREDIT AND SECURITY
AGREEMENT AND WAIVER OF DEFAULTS

This Amendment, dated as of February 9, 2000, is made by and between LECTEC CORPORATION, a Minnesota corporation (the "Borrower"), and WELLS FARGO BUSINESS CREDIT, INC., a Minnesota corporation (the "Lender").

Recitals

The Borrower and the Lender have entered into a Credit and Security Agreement dated as of November 22, 1999 (the "Credit Agreement"). Capitalized terms used in these recitals have the meanings given to them in the Credit Agreement unless otherwise specified.

The Borrower has requested that certain amendments be made to the Credit Agreement, which the Lender is willing to make pursuant to the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements herein contained, it is agreed as follows:

1. **Defined Terms.** Capitalized terms used in this Amendment which are defined in the Credit Agreement shall have the same meanings as defined therein, unless otherwise defined herein.

2. **Minimum Book Net Worth.** Section 6.12 of the Credit Agreement is hereby deleted its entirety and replaced with the following:

Section 6.12 Minimum Book Net Worth. The Borrower will maintain, during each period described below, its Book Net Worth, determined as at the end of each month, at an amount not less than the amount set forth opposite such period:

Period Ended	Minimum Book Net Worth
January 31, 2000	\$5,428,000
February 29, 2000	\$5,428,000
March 31, 2000	\$5,428,000
April 30, 2000	\$5,178,000
May 31, 2000	\$4,978,000
June 30, 2000	\$4,808,000

3. **Minimum Earnings/Maximum Loss Before Taxes.** Section 6.13 of the Credit Agreement is hereby deleted in its entirety and replaced with the following:

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Section 6.13 Minimum Earnings/Maximum Loss Before Taxes. The Borrower will achieve during each period described below, year-to-date Earnings or Loss Before Taxes, of not less than/greater than the amount set forth opposite such period (bracketed amounts indicate maximum Loss Before Taxes):

Period Ended	Minimum Earnings/Maximum Loss Before Taxes
January 31, 2000	(\$2,080,000)
February 29, 2000	(\$2,080,000)
March 31, 2000	(\$2,080,000)
April 30, 2000	(\$2,330,000)
May 31, 2000	(\$2,530,000)
June 30, 2000	(\$2,700,000)

4. No Other Changes. Except as explicitly amended by this Amendment, all of the terms and conditions of the Credit Agreement shall remain in full force and effect and shall apply to any advance or letter of credit thereunder.

5. Waiver of Defaults. The Borrower is in default of the following provisions of the Credit Agreement (collectively, the "Defaults"):

(a) the Minimum Book Net Worth covenant set forth in Section 6.12 as of November 30, 1999; and

(b) the Minimum Earnings/Maximum Loss Before Taxes covenant set forth in Section 6.13 as of November 30, 1999 and December 31, 1999.

Upon the terms and subject to the conditions set forth in this Amendment, the Lender hereby waives the Defaults. This waiver shall be effective only in this specific instance and for the specific purpose for which it is given, and this waiver shall not entitle the Borrower to any other or further waiver in any similar or other circumstances.

6. Conditions Precedent. This Amendment, and the waiver set forth in Paragraph 5 hereof, shall be effective when the Lender shall have received an executed original hereof.

7. Representations and Warranties. The Borrower hereby represents and warrants to the Lender as follows:

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(a) The Borrower has all requisite power and authority to execute this Amendment and to perform all of its obligations hereunder, and this Amendment has been duly executed and delivered by the Borrower and constitutes the legal, valid and binding obligation of the Borrower, enforceable in accordance with its terms.

(b) The execution, delivery and performance by the Borrower of this Amendment have been duly authorized by all necessary corporate action and do not (i) require any authorization, consent or approval by any governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, (ii) violate any provision of any law, rule or regulation or of any order, writ, injunction or decree presently in effect, having applicability to the Borrower, or the articles of incorporation or by-laws of the Borrower, or (iii) result in a breach of or constitute a default under any indenture or loan or credit agreement or any other agreement, lease or instrument to which the Borrower is a party or by which it or its properties may be bound or affected.

(c) All of the representations and warranties contained in Article V of the Credit Agreement are correct on and as of the date hereof as though made on and as of such date, except to the extent that such representations and warranties relate solely to an earlier date.

8. References. All references in the Credit Agreement to "this Agreement" shall be deemed to refer to the Credit Agreement as amended hereby; and any and all references in the Security Documents to the Credit Agreement shall be deemed to refer to the Credit Agreement as amended hereby.

9. No Other Waiver. Except as set forth in Paragraph 5 hereof, the execution of this Amendment and acceptance of any documents related hereto shall not be deemed to be a waiver of any Default or Event of Default under the Credit Agreement or breach, default or event of default under any Security Document or other document held by the Lender, whether or not known to the Lender and whether or not existing on the date of this Amendment.

10. Release. The Borrower hereby absolutely and unconditionally releases and forever discharges the Lender, and any and all participants, parent corporations, subsidiary corporations, affiliated corporations, insurers, indemnitors, successors and assigns thereof, together with all of the present and former directors, officers, agents and employees of any of the foregoing, from any and all claims, demands or causes of action of any kind, nature or description, whether arising in law or equity or upon contract or tort or under any state or federal law or otherwise, which the Borrower has had, now has or has made claim to have against any such person for or by reason of any act, omission, matter, cause or thing whatsoever arising from the beginning of time to and including the date of this Amendment, whether such claims, demands and causes of action are matured or unmatured or known or unknown.

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11. Costs and Expenses. The Borrower hereby reaffirms its agreement under the Credit Agreement to pay or reimburse the Lender on demand for all costs and expenses incurred by the Lender in connection with the Credit Agreement, the Security Documents and all other documents contemplated thereby, including without limitation all reasonable fees and disbursements of legal counsel. Without limiting the generality of the foregoing, the Borrower specifically agrees to pay all fees and disbursements of counsel to the Lender for the services performed by such counsel in connection with the preparation of this Amendment and the documents and instruments incidental hereto. The Borrower hereby agrees that the Lender may, at any time or from time to time in its sole discretion and without further authorization by the Borrower, make a loan to the Borrower under the Credit Agreement, or apply the proceeds of any loan, for the purpose of paying any such fees, disbursements, costs and expenses.

12. Miscellaneous. This Amendment may be executed in any number of counterparts, each of which when so executed and delivered shall be deemed an original and all of which counterparts, taken together, shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed as of the date first written above.

WELLS FARGO BUSINESS CREDIT, INC.

LECTEC CORPORATION

By /s/ Diane G. Conley

By /s/ Deborah L. Moore

Diane G. Conley
An Officer

Deborah L. Moore
Its Chief Financial Officer

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