

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

FORM 10-QSB

☒ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005.

☐ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT FOR THE TRANSITION PERIOD FROM _____ to _____

Commission file number: 0-16159

LECTEC CORPORATION

(Exact name of small business issuer as specified in its charter)

Minnesota

41-1301878

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

5616 Lincoln Drive, Edina, Minnesota

55436

(Address of principal executive offices)

(Zip Code)

(952) 933-2291

(Issuer's telephone number)

Not Applicable

(Former name, former address and former fiscal year, if changed from
last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes ☒ No ☐

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

Yes ☐ No ☒

The number of shares outstanding of the issuer's common stock as of November 14, 2005 was 4,148,998 shares.

Transitional Small Business Disclosure Format (Check one):

Yes ☐ No ☒

LECTEC CORPORATION

REPORT ON FORM 10-QSB FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005

TABLE OF CONTENTS

<TABLE>

<S>

<C>

PART I - FINANCIAL INFORMATION

Item 1.	Condensed Financial Statements and Notes to Condensed Financial Statements.....	I-1
Item 2.	Management's Discussion and Analysis or Plan of Operation.....	I-9
Item 3.	Controls and Procedures	I-12

PART II - OTHER INFORMATION

Item 1.	Legal Proceedings.....	II-1
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds....	II-1
Item 3.	Defaults Upon Senior Securities.....	II-1
Item 4.	Submission of Matters to a Vote of Security Holders	II-1
Item 5.	Other Information.....	II-1
Item 6.	Exhibits.....	II-1
	Signature Page.....	II-2

</TABLE>

FORWARD-LOOKING STATEMENTS

From time to time, in reports filed with the Securities and Exchange

Commission (including this Form 10-QSB), 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 Company's dependence on royalty payments from Novartis Consumer Health, Inc. ("Novartis") and on key personnel, the success or failure of any attempt by the Company to protect or enforce its patents, issuance of new accounting pronouncements; available opportunities for licensing agreements related to patents that the Company holds, and other risks and uncertainties as described in the "Cautionary Statements" filed as Exhibit 99.01 to the Company's Report on Form 10-KSB for the year ended December 31, 2004.

PART 1 - FINANCIAL INFORMATION

ITEM 1 - CONDENSED FINANCIAL STATEMENTS AND NOTES TO CONDENSED FINANCIAL STATEMENTS

LECTEC CORPORATION CONDENSED BALANCE SHEETS

<TABLE>
<CAPTION>

ASSETS	September 30, 2005 (Unaudited) <C>	December 31, 2004 <C>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,354,788	\$ 2,239,318
Royalty receivable	69,611	-
Prepaid expenses and other	75,188	137,981
Discontinued operations	-	192,629
Total current assets	1,499,587	2,569,928
OTHER ASSETS:		
Patents and trademarks	97,587	50,693
Prepaid insurance - director and officer	152,094	182,513
	249,681	233,206
	\$ 1,749,268	\$ 2,803,134
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term obligations	\$ -	\$ 2,525
Accounts payable	52,975	4,944
Accrued expenses	73,553	240,293
Discontinued operations	98,350	273,290
Total current liabilities	224,878	521,052
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Common stock, \$.01 par value; 15,000,000 shares authorized; 4,148,998 and 4,030,330 shares issued and outstanding at September 30, 2005 and December 31, 2004, respectively	41,490	40,303
Additional contributed capital	11,847,536	11,689,404
Accumulated deficit	(10,364,636)	(9,447,625)
	1,524,390	2,282,082
	\$ 1,749,268	\$ 2,803,134
	=====	=====

</TABLE>

Note: The balance sheet as of December 31, 2004 has been condensed from the audited financial statements.

The accompanying notes are an integral part of these condensed financial statements.

I-1

LECTEC CORPORATION CONDENSED STATEMENTS OF OPERATIONS (Unaudited)

<TABLE>
<CAPTION>

Three Months Ended September 30,	Nine Months Ended September 30,
-------------------------------------	------------------------------------

	2005	2004	2005	2004
		(Restated)		(Restated)
<S>	<C>	<C>	<C>	<C>
CONTINUING OPERATIONS:				
Revenue - royalty and licensing fee income	\$ 68,717	\$ 1,065,000	\$ 189,195	\$ 1,065,000
Operating expenses	87,850	315,492	653,292	907,866
Earnings (loss) from continuing operations before income taxes	(19,133)	749,508	(464,097)	157,134
Income tax expense	-	1,825	-	1,825
Earning (loss) from continuing operations	\$ (19,133)	\$ 747,683	\$ (464,097)	\$ 155,309
DISCONTINUED OPERATIONS:				
Earnings (loss) from discontinued operations before income taxes	\$ 19,512	\$ 421,913	\$ (206,090)	\$ 1,097,853
Income tax expense	-	12,757	-	12,757
Earning (loss) from discontinued operations	\$ 19,512	\$ 409,156	\$ (206,090)	\$ 1,085,096
NET EARNINGS (LOSS)	\$ 379	\$ 1,156,839	\$ (670,187)	\$ 1,240,405
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	4,148,998	4,021,899	4,129,262	4,005,831
Diluted	4,148,998	4,174,772	4,129,262	4,121,212
EARNINGS (LOSS) PER SHARE:				
Basic:				
Continuing operations	\$ (0.00)	\$ 0.19	\$ (0.11)	\$ 0.04
Discontinued operations	0.00	0.10	(0.05)	0.27
Total	\$ 0.00	\$ 0.29	\$ (0.16)	\$ 0.31
Diluted:				
Continuing operations	\$ (0.00)	\$ 0.18	\$ (0.11)	\$ 0.04
Discontinued operations	0.00	0.10	(0.05)	0.26
Total	\$ 0.00	\$ 0.28	\$ (0.16)	\$ 0.30

</TABLE>

The accompanying notes are an integral part of these condensed financial statements.

I-2

LECTEC CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

<TABLE>
<CAPTION>

	Nine Months ended September 30,	
	2005	2004
		(Restated)
<S>	<C>	<C>
Cash flows from operating activities:		
Earnings (loss) from continuing operations	\$ (464,097)	\$ 155,309
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities:		
Earnings (loss) from discontinued operations	(206,090)	1,085,096
Loss on impaired assets	-	115,054
Depreciation and amortization	13,106	205,740
Gain on sale of property, plant and equipment	-	(138,055)
Compensation expense related to re-priced stock options	69,092	95,040
Changes in continuing operations assets and liabilities:		
Royalty receivable	(69,611)	-
Prepaid expenses and other	93,212	(129,048)
Accounts payable	48,031	(2,136)
Accrued expenses	(166,740)	53,044
Change in net assets and liabilities of discontinued operations	17,689	113,917
Net cash provided by (used in) operating activities	(665,408)	1,553,961
Cash flows from investing activities:		
Investment in patents	(60,000)	(31,473)
Purchases of property, plant and equipment	-	(74,550)
Proceeds from sales of property, plant and equipment	-	162,700
Net cash provided by (used in) investing activities	(60,000)	56,677

Cash flows from financing activities:		
Cash dividends paid	(246,824)	-
Proceeds from exercise of stock options	90,227	24,911
Repayment of long-term obligations	(2,525)	(9,177)
	-----	-----
Net cash provided by (used in) financing activities	(159,122)	15,734
	-----	-----
Net increase (decrease) in cash and cash equivalents	(884,530)	1,626,372
	-----	-----
Cash and cash equivalents - beginning of period	2,239,318	483,844
	-----	-----
Cash and cash equivalents - end of period	\$ 1,354,788	\$ 2,110,216
	=====	=====
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 4,126	\$ 6,804
Licensing fees used to reduce long-term obligations and accrued interest	-	250,000

</TABLE>

The accompanying notes are an integral part of these condensed financial statements.

I-3

LECTEC CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004

(UNAUDITED)

(1) GENERAL

The accompanying condensed financial statements include the accounts of Lectec Corporation (the "Company") as of September 30, 2005 and December 31, 2004 and for the three and nine month periods ended September 30, 2005 and 2004. The Company's condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and should be read in conjunction with the Company's Annual Report on Form 10-KSB for the year ended December 31, 2004. The interim condensed 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 full year.

(2) BUSINESS SUMMARY AND CRITICAL ACCOUNTING POLICIES

BUSINESS SUMMARY

The Company is an intellectual property licensing and holding company. The Company receives royalties and licensing fees from licensing agreements pertaining to the Company's patents. The Company has one licensing agreement ("Novartis Agreement" or "Agreement") with Novartis Consumer Health, Inc. ("Novartis"), which pays royalties to the Company on a semi-annual basis or from time to time based upon a percentage of Novartis net sales of licensed products. The Company was a contract manufacturer of hydrogel topical patches which were sold to major pharmaceutical customers until the Company ceased its manufacturing operations in December 2004. See the discussion under "Licensing and Supply Agreement" in Note 5 of Notes to Condensed Financial Statements for a description of the agreement with Novartis.

CRITICAL ACCOUNTING POLICIES

The Company's critical accounting policies include:

Revenue Recognition. Royalty and licensing income is recognized when earned under the terms of the agreements with customers and collection is reasonably assured. Revenue from sales from discontinued operations were recognized when the product was shipped to the customer and collection was probable.

Long-Lived Assets. The carrying value of long-lived assets is reviewed periodically or when factors indicating impairment are present. The amount of impairment loss is measured as the amount by which the carrying value of the assets exceeds the fair value of the assets. The Company believes no impairment exists as of September 30, 2005. Patent costs are amortized over five years.

Royalty Receivable. The Company has a royalty receivable under the terms of an Agreement with Novartis. The Company granted credit to Novartis in the normal course of business and management believes, based upon past experience, that all amounts outstanding are fully collectible. Royalty income recognized during the three and nine months ended September 30, 2005 is based on net sales information provided by Novartis, covering sales of products under the licensing agreement for the applicable periods. Pursuant to the Agreement, the Company has the right to audit the validity of the net annual sales of products covered under the Agreement. See the discussion under "Licensing and Supply Agreement" in Note 5 of Notes to Condensed Financial Statements for a description of the Agreement with Novartis.

I-4

Accounting for Discontinued Operations. Under the provisions of Statement of Financial Accounting Standard ("SFAS") No. 144, if a component of an entity is either classified as held-for-sale or has been disposed of during the period, the results of its operations are to be reported in discontinued operations,

provided that both of the following conditions are met:

- The operations and cash flows of the component have been or will be removed from the ongoing operations of the entity as a result of the disposal transaction, and
- The entity will have no significant continuing involvement in the operations of the component after the disposal transaction.

The Company exited from manufacturing operations of topical patches and sold off substantially all of its manufacturing assets related to the production of patches to its only remaining customer, Novartis, as of December 31, 2004. The assets related to the Company's manufacturing operations have been classified as discontinued operations due to the sale of the manufacturing assets prior to December 31, 2004. The operations and cash flows of the contract manufacturing operations were eliminated from the ongoing operations as a result of the sale transaction. The surviving entity (intellectual property licensing and holding company) will not have any significant involvement in the operations of the previously sold manufacturing operations. It is therefore management's position that the conditions for reporting the Company's financial statements under the requirements of SFAS 144 as discontinued operations have been satisfied. The comparative 2004 condensed statements of operations and cash flows have been restated to conform to the 2005 presentation.

The Company used reasonable judgment combined with quantitative analysis in determining the amounts of assets, liabilities, revenues and expenses that would be allocated between continuing operations and discontinued operations.

Stock Based Compensation. In January 2005, the Company extended the exercise period for options held by two former executive officers of the Company and one former employee by two years from the date of their respective termination dates (but not longer than the stock options normal expiration date, if earlier). There were 222,667 options with a weighted average exercise price of \$0.83 per share subject to the modification in the exercise period. Normally, these options would expire ninety days from the employees termination date. Because of the modification to the terms related to the exercise period granted to those former employees, the Company recorded a one time compensation expense of \$99,957 during the first quarter ended March 31, 2005.

In July 2002, 803,958 stock options with a weighted average exercise price of \$4.54 per share were re-priced to \$0.81 per share. At September 30, 2005, 95,000 of these options were outstanding and exercisable. No compensation expense was recorded by the Company in connection with the re-pricing because the exercise price exceeded the market price on the date of the re-pricing. On September 30, 2005, the market price for the Company's common stock was \$0.75, and below the exercise price of the re-priced options. Accordingly, the Company incrementally reversed previously recorded compensation expense of \$75,900 for the three months ended September 30, 2005, effectively adjusting the compensation expense back to the re-priced value of \$0.81 per share. For the nine months ended September 30, 2005, the Company recorded net compensation expense of \$69,092 in connection with the re-pricing and modified options.

The Company utilizes the intrinsic value method of accounting for stock based employee compensation plans. All options granted had an exercise price equal to the market value of the underlying common stock on the date of grant, and no compensation cost related to stock option grants is reflected in net income or loss for the three and nine months ended September 30, 2005 and 2004. The following table illustrates the effect on net earnings (loss) if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation:

I-5

<TABLE>
<CAPTION>

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
<S>	<C>	<C>	<C>	<C>
Net earnings (loss), as reported	\$ 379	\$ 1,156,839	\$ (670,187)	\$ 1,240,405
Compensation income (expense) determined under the fair value method	116	(26,768)	352	(80,344)
Proforma net earnings (loss)	\$ 495	\$ 1,130,071	\$ (669,835)	\$ 1,160,061
Net earnings (loss) per share:				
As reported -				
Basic earnings (loss) per share:				
Continuing operations	\$ (0.00)	\$ 0.19	\$ (0.11)	\$ 0.04
Discontinued operations	0.00	0.10	(0.05)	0.27
Total	\$ 0.00	\$ 0.29	\$ (0.16)	\$ 0.31
Diluted earnings (loss) per share:				
Continuing operations	\$ (0.00)	\$ 0.18	\$ (0.11)	\$ 0.04
Discontinued operations	0.00	0.10	(0.05)	0.26
Total	\$ 0.00	\$ 0.28	\$ (0.16)	\$ 0.30

Proforma -

Basic earnings (loss) per share:

Continuing operations	\$ (0.00)	\$ 0.18	\$ (0.11)	\$ 0.02
Discontinued operations	0.00	0.10	(0.05)	0.27
Total	\$ 0.00	\$ 0.28	\$ (0.16)	\$ 0.29

Diluted earnings (loss) per share:

Continuing operations	\$ (0.00)	\$ 0.17	\$ (0.11)	\$ 0.02
Discontinued operations	0.00	0.10	(0.05)	0.26
Total	\$ 0.00	\$ 0.27	\$ (0.16)	\$ 0.28

</TABLE>

The proforma information above should be read in conjunction with the related historical information.

There were no stock options granted during the nine months ended September 30, 2005. The weighted average fair value of options granted during the nine months ended September 30, 2004 was \$1.09. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions used for all grants during the nine months ended September 30, 2004 and 2005; zero dividend yield, expected volatility of 179%, risk-free interest rate of 2.72% and expected life of 3.0 years.

Management believes the Black-Scholes option valuation model currently provides the best estimate of fair value. However, the Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of several subjective assumptions. The Company's employee and director stock options have characteristics different from those of traded options, and changes in the subjective input assumptions can materially affect the fair value estimate.

(3) EARNINGS (LOSS) PER SHARE

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

I-6

Common stock options and warrants to purchase 250,200 and 601,417 shares of common stock with a weighted average exercise price of \$3.48 and \$1.98 were outstanding during the three and nine months ended September 30, 2005, respectively. Common stock options and warrants to purchase 266,028 and 373,472 shares of common stock with a weighted average exercise price of \$4.55 and \$3.62 were outstanding during the three and nine months ended September 30, 2004, respectively. These shares were excluded from the earnings (loss) per share computations because they were antidilutive.

(4) INCOME TAXES

The provision for income taxes for the three and nine months ended September 30, 2005, was offset principally by a valuation allowance for deferred taxes. Federal and state income taxes of \$14,582 were provided for the three and nine months ended September 30, 2004, due to having alternative minimum taxable income after using available tax credits and net operating loss carryforwards.

(5) LICENSING AND SUPPLY AGREEMENT

On July 19, 2004, the Company entered into the Novartis Agreement, effective as of January 1, 2004. The Agreement replaced the Company's prior licensing and supply agreement with Novartis dated May 8, 2002. The Agreement required the Company to manufacture, sell and deliver to Novartis vapor patches for sale to the pediatric market in the United States, Canada and Mexico. In order to provide the Company with working capital funds necessary to enable it to manufacture and deliver vapor patches to Novartis in accordance with the Agreement, Novartis advanced up to \$2,000,000 for use by the Company to pay accounts payable and expenses incurred exclusively for the manufacture and delivery of vapor patches. In consideration of any advanced funds, the Company executed and delivered to Novartis a promissory note of \$2,000,000 and a security agreement. Under the security agreement, the Company pledged substantially all of its assets. The Company repaid the note by the delivery to Novartis of vapor patches under the Agreement. All amounts owed were repaid as of December 31, 2004. Under the Agreement, Novartis had the option until March 31, 2005, to extend the use of vapor patches to the adult cough/cold category in the United States, Canada and Mexico at no additional cost and under the same terms and conditions as set forth in the Agreement. On March 31, 2005, Novartis notified the Company of its desire to exercise the option to enter the adult market pursuant to the Agreement. There can be assurance that Novartis will actually introduce any product into the adult market.

Under the Agreement, the Company granted Novartis an exclusive license (the "License") to all of the intellectual property of the Company to the extent that it is used or useful in the production of the vapor patches being supplied under the Agreement for a fee of \$1,065,000, which was paid to the Company by Novartis as follows: (1) release of \$250,000 in promissory note debt as of the

date of the Agreement, (2) payment of \$407,500 in cash in July 2004, and (3) payment of \$407,500 in cash in September 2004. The License began on July 19, 2004, and will continue for the duration of any patents included in the licensed intellectual property and, with respect to all other elements of the licensed intellectual property, for the maximum duration permitted under applicable law (fourteen years). Upon the expiration of the patents included in the licensed intellectual property, Novartis will have a non-revocable, perpetual, fully paid-up license to the intellectual property used or useful in the production of vapor patches for the pediatric market and the adult cough/cold market. Commencing on January 1, 2005, Novartis is required by the Agreement to pay royalties, at an agreed upon percentage, to the Company, based upon the net sales of vapor patches by Novartis for each year the License is in effect.

The supply portion of the Agreement concluded on February 5, 2005, however, the provisions relating to the License will continue in effect until the conclusion of the term of the License. The Company may not assign or otherwise transfer the Agreement (other than to an affiliate) without the prior written consent of Novartis. Novartis may object to an assignment only if such acquirer or successor is a direct competitor of Novartis.

In conjunction with the signing of the Agreement, Novartis purchased certain manufacturing equipment from the Company for approximately \$900,000 during the second half of 2004.

As of September 30, 2005, the Company has received royalty payments of \$119,584 based on net sales by Novartis of products covered under the Agreement that were sold during the first six months ended June 30, 2005.

I-7

(6) DISCONTINUED OPERATIONS

Discontinued operations assets and liabilities and income statement information include the following:

<TABLE>
<CAPTION>

	September 30, 2005	December 31, 2004
<S>	<C>	<C>
DISCONTINUED OPERATIONS - ASSETS		
Accounts receivable, net	\$ -	\$ 176,207
Prepaid expenses and other	-	16,422
Total discontinued operations - assets	\$ -	\$ 192,629
DISCONTINUED OPERATIONS - LIABILITIES		
Accounts payable	\$ -	\$ 21,267
Accrued expenses	-	152,023
Reserve for sales returns and credits	98,350	100,000
Total discontinued operations - liabilities	\$ 98,350	\$ 273,290

</TABLE>

DISCONTINUED OPERATIONS EARNINGS (LOSS) (UNAUDITED):

<TABLE>
<CAPTION>

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
<S>	<C>	<C>	<C>	<C>
Discontinued operations revenues	\$ -	\$1,483,639	\$ -	\$ 5,483,085
Discontinued operations earnings (loss) before gain on sale of property and equipment	\$ 17,462	\$ 271,101	\$ (275,492)	\$ 947,041
Gain on sale of property and equipment from discontinued operations *	2,050	138,055	69,402	138,055
Earnings (loss) from discontinued operations	\$ 19,512	\$ 409,156	\$ (206,090)	\$1,085,096

</TABLE>

* The assets sold for the three and nine months ended September 30, 2005, were fully depreciated at the time of sale.

I-8

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

RESULTS OF OPERATIONS

In July 2004, management determined that the Company would wind down and cease its contract manufacturing operations by December 31, 2004. Because of

this, the past and future financial results related to contract manufacturing have been treated as discontinued operations for financial reporting purposes. Continuing operations consist of operations related to the surviving intellectual property licensing and holding company. The Company accounts for its discontinued operations under the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Accordingly, results of operations and the related charges for discontinued operations have been classified as "Earnings (loss) from discontinued operations" in the accompanying Condensed Statements of Operations. Assets and liabilities of the discontinued operations have been reclassified and reflected in the accompanying Balance Sheets as "Discontinued operations". For comparative purposes, all prior periods presented have been restated to reflect the reclassifications on a consistent basis.

COMPARISON OF THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004

RESULTS OF CONTINUING OPERATIONS

The Company recorded royalty income of \$68,717 and \$189,195 during the three and nine months ended September 30, 2005, respectively, related to its licensing agreement with Novartis. The Company recorded licensing fee income from continuing operations of \$1,065,000 for the three and nine months ended September 30, 2004, related to the Novartis Agreement, (See Note 5 of Notes to Condensed Financial Statements on page I-7 of this Report).

For the third quarter ended September 30, 2005, the Company recorded a net loss from continuing operations of \$(19,133), or \$(0.00) per basic and diluted share, compared to earnings from continuing operations of \$747,683, or \$0.19 and \$0.18 per basic and diluted share, respectively, for the same quarter in 2004. For the nine months ended September 30, 2005, the Company recorded a net loss from continuing operations of \$(464,097), or \$(0.11) per basic and diluted share, respectively, compared to earnings from continuing operations of \$155,309, or \$0.04 per basic and diluted share, for the same period in the 2004. The decrease in net earnings from continuing operations for both the three and nine month periods ended September 30, 2005 compared to the same periods in the prior year were primarily due to the recognition of licensing fee income of \$1,065,000 during the third quarter ended September 30, 2004, and partially offset by royalty income earned during 2005, in conjunction with general operating expenses related to the current operations of the Company during 2005.

RESULTS OF DISCONTINUED OPERATIONS

The earnings from discontinued operations for the third quarter ended September 30, 2005 was \$19,512, or \$0.00 per basic and diluted share, compared to earnings from discontinued operations of \$409,156 or \$0.10 per basic and diluted share for the same period in 2004. The earnings from discontinued operations for the third quarter ended September 30, 2005 was due primarily to the reversal of compensation expense for previous employees of the Company and from miscellaneous sales of fully depreciated assets. For the nine months ended September 30, 2005, the loss from discontinued operations was \$(206,090), or \$(0.05) per basic and diluted share, compared to earnings from discontinued operations of \$1,085,096 or \$0.27 and \$0.26 per basic and diluted share, respectively, for the same period in 2004. For the three and nine months ended September 30, 2004, sales to the Company's largest customer, Novartis, were \$1,219,646 and \$4,007,352, respectively. There were no product sales to any customers during 2005. The decrease in the earnings from discontinued operations for both the three and nine month periods in 2005 compared to the same periods in 2004 is attributable to the completion of the wind down of contract manufacturing operations.

NET RESULTS OF OPERATIONS

The net income for the third quarter ended September 30, 2005 was \$379, or \$0.00 per basic and diluted share, compared to net earnings of \$1,156,839, or \$0.29 and \$0.28 per basic and diluted share, respectively, for the same period in 2004. For the nine months ended September 30, 2005, the net loss was \$(670,187), or \$(0.16) per basic and diluted share, compared to net earnings of \$1,240,405, or \$0.31 and \$0.30 per basic and diluted share, respectively, for the same period in 2004. The overall decline in results of operations for the three and nine month periods ended September 30, 2005 over the same periods in the prior year is primarily due to the absence of net sales and gross profit from discontinued operations related to the wind down of contract manufacturing operations and the reasons stated above.

I-9

INCOME TAXES

The provision for income tax expense for the three and nine months ended September 30, 2005 was offset principally by a valuation allowance for deferred taxes. Federal and state income taxes for the three and nine months ended September 30, 2004 of \$14,582 resulted from alternative minimum taxes because of a partial disallowance of available tax credits and net operating loss carryforwards for those periods.

EFFECT OF INFLATION

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

WIND DOWN OF MANUFACTURING OPERATIONS

In September 2003, the Company learned that, as a result of a change in its internal supplier selection criteria, Novartis, the Company's largest customer, intended to stop using the Company as a contract manufacturer for its

topical patches by the end of 2004. In addition, Johnson & Johnson Consumer Products Company, the Company's second largest customer, also indicated that it intended to stop using the Company as a contract manufacturer during 2004. Based on this situation and without any other manufacturing prospects, in July 2004, the Board of Directors determined that the Company would cease manufacturing operations by December 31, 2004 and decided to become an intellectual property licensing and holding company.

On July 19, 2004, the Company entered into the Novartis Agreement, effective as of January 1, 2004. The Agreement replaced the Company's prior licensing and supply agreement with Novartis dated May 8, 2002. The Agreement required the Company to manufacture, sell and deliver to Novartis vapor patches for sale to the pediatric market in the United States, Canada and Mexico. In order to provide the Company with working capital funds necessary to enable it to manufacture and deliver vapor patches to Novartis in accordance with the Agreement, Novartis advanced up to \$2,000,000 for use by the Company to pay accounts payable and expenses incurred exclusively for the manufacture and delivery of vapor patches. In consideration of any advanced funds, the Company executed and delivered to Novartis a promissory note of \$2,000,000 and a security agreement. Under the security agreement, the Company pledged substantially all of its assets. The note was repaid by the Company by the delivery to Novartis of vapor patches under the Agreement. All amounts owed were repaid as of December 31, 2004. Under the Agreement, Novartis had the option until March 31, 2005 to extend the use of vapor patches to the adult cough/cold category in the United States, Canada and Mexico at no additional cost and under the same terms and conditions as set forth in the Agreement. On March 31, 2005, Novartis notified the Company of its desire to exercise the option to enter the adult market pursuant to the Agreement. There can be assurance that Novartis will actually introduce any product into the adult market.

Under the Agreement, the Company granted Novartis an exclusive license (the "License") to all of the intellectual property of the Company to the extent that it is used or useful in the production of the vapor patches being supplied under the Agreement for a fee of \$1,065,000, which was paid to the Company by Novartis as follows: (1) release of \$250,000 in promissory note debt as of the date of the Agreement, (2) payment of \$407,500 in cash in July 2004, and (3) payment of \$407,500 in cash in September 2004. The License began on July 19, 2004, and will continue for the duration of any patents included in the licensed intellectual property and, with respect to all other elements of the licensed intellectual property, for the maximum duration permitted under applicable law (maximum fourteen years). Upon the expiration of the patents included in the licensed intellectual property, Novartis will have a non-revocable, perpetual, fully paid-up license to the intellectual property used or useful in the production of vapor patches for the pediatric market and the adult cough/cold market. Commencing on January 1, 2005, Novartis is required by the Agreement to pay royalties, at an agreed upon percentage, to the Company, based upon the net sales of vapor patches by Novartis for each year the License is in effect.

In August 2004, Novartis purchased a cartoning machine from the Company for a purchase price of \$162,000. In December, 2004, the Company entered into a capital equipment purchase agreement (the "Purchase Agreement") with Novartis. Under the Purchase Agreement, Novartis paid the Company the contract price of \$733,100 in exchange for the Company's hydrogel coating and therapeutic converting machinery and equipment. The contract price was

I-10

based upon Novartis taking delivery of the equipment at the Company's facility. Upon closing of this disposition of assets to Novartis on December 29, 2004, the Company's transformation from a manufacturing operation to an intellectual property licensing and holding company was complete.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents decreased by \$884,530 during the first nine months of 2005 to \$1,354,788 at September 30, 2005. The decrease in cash and cash equivalents during the first nine months of 2005 was due to cash used in operating activities of \$665,408 consisting primarily of cash used for continuing operations as well as severance and other manufacturing wind down costs, the payment of a cash dividend of \$246,824 during the first quarter of 2005, which was partially offset by the receipt of \$119,584 in cash received from royalties under the Novartis agreement. See the discussion under "Licensing and Supply Agreement" in Note 5 of Notes to Condensed Financial Statements for a description of the agreement with Novartis.

During the first nine months of 2005, the Company received \$176,207 from Novartis under accounts receivable related to discontinued operations and received proceeds of \$90,227 related to exercises of stock options. The Company received proceeds of \$69,402 from the sale of miscellaneous equipment and office furniture having no book value during the first nine months of 2005. The Company also expended and capitalized \$60,000 in patent related costs. There are no future material commitments for capital expenditures at September 30, 2005.

The Company had working capital of \$1,274,709 and a current ratio of 6.67 at September 30, 2005 compared to working capital of \$2,048,876 and a current ratio of 4.93 at December 31, 2004. The decrease in working capital during the first nine months of 2005 is primarily attributable to lower accounts payables and accrued expenses as a result of the Company paying severance and manufacturing wind down obligations, the payment of a cash dividend, and a reduction in accounts receivable partially offset with an increase in royalty receivable. The improvement in the Company's current ratio is a result of the settlement of liabilities associated with the Company's discontinued operations and the reasons stated above.

Shareholders' equity decreased to \$1,524,390 at September 30, 2005 from

\$2,282,082 at December 31, 2004, which is primarily due to the net loss for the nine months ended September 30, 2005 coupled with the payment of a cash dividend of \$246,824 in March 2005, in conjunction with other items discussed above.

The Company believes its existing cash and cash equivalents will be sufficient to fund continuing operations through 2005. However, cash and cash equivalents may not be sufficient to fund continuing operations beyond 2005. The Company's working capital requirements are dependent upon adequate levels of royalty and licensing fee income to fund continuing operations. Royalty income is uncertain because it is subject to factors that the Company cannot control. Such factors include, but are not limited to, seasonality of the product resulting from the severity of the flu/cough and cold conditions in the marketplace, marketing efforts by Novartis, markets Novartis enters the product into, and other factors which can cause fluctuations in the amount of royalty income the Company receives. There can be no assurance because of these uncertainties that future royalty income will be sufficient to fund continuing operations. The royalty income of \$189,195 recorded for the nine months ended September 30, 2005 was based upon information provided by Novartis calculated as a percentage of net sales of products covered under the licensing agreement the Company has with Novartis. There can be no assurance that this result will be indicative of results for the full year. Furthermore, future royalties and licensing income the Company anticipates earning is dependent on the success of the product in the marketplace by Novartis and other firms or individuals with whom the Company may enter into licensing agreements. Additionally, the Company does not presently have any other financing resources in place from which it can borrow or obtain additional working capital.

CRITICAL ACCOUNTING POLICIES

Management believes that the Company has not adopted any critical accounting policies which, if changed, would result in a material change in financial estimates, financial condition, results of operation or cash flows for the three and nine months ended September 30, 2005 and 2004. The critical accounting policies appear in Note 2 of Notes to Condensed Financial Statement in this Form 10-QSB.

I-11

ITEM 3 - CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our principal executive and financial officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based upon this evaluation, the principal executive and financial officer has concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

During the three months ended September 30, 2005, there were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

I-12

PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

None.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5 - OTHER INFORMATION

None.

ITEM 6 - EXHIBITS

<TABLE>

<CAPTION>

Exhibit No.	Description
<S>	<C>
3.01	Articles of Incorporation of LecTec Corporation, as amended (Incorporated herein by reference to the Company's Form S-1 Registration Statement (file number 33-9774C) filed on October 31, 1986 and amended on December 12, 1986).
3.02	Bylaws of LecTec Corporation (Incorporated herein by reference to the Company's Form S-1 Registration Statement (file number 33-9774C) filed on October 31, 1986 and amended on December 12, 1986).

31.01	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
31.02	Certification of Acting Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.01	Chief Executive Officer and Acting Chief Financial Officer Certification Pursuant to #18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
99.01	Cautionary Statements (Incorporated herein by reference to Exhibit 99.01 to the Company's Report on Form 10-KSB for the fiscal year ended December 31, 2004).

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II-1

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LECTEC CORPORATION

Date November 14, 2005

By /s/ Alan C. Hymes, M.D.

 Alan C. Hymes, M.D.
 Chief Executive Officer & Director
 (principal financial officer and duly
 authorized officer)

II-2

EXHIBIT INDEX

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99.01	Cautionary Statements (Incorporated herein by reference to Exhibit 99.01 to the Company's Report on Form 10-KSB for the fiscal year ended December 31, 2004).

</TABLE>

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

I, Alan C. Hymes, M.D., Chief Executive Officer and President of LecTec Corporation, a Minnesota corporation, certify that:

1. I have reviewed this Quarterly Report on Form 10-QSB of LecTec Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4. The small business issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and have;

- a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- c) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and

5. The small business issuer's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: November 14, 2005

/s/ Alan C. Hymes, M.D.

Alan C. Hymes, M.D.
Chief Executive Officer

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Alan C. Hymes, M.D., Chief Executive Officer of LecTec Corporation, a Minnesota corporation, certify that:

1. I have reviewed this Quarterly Report on Form 10-QSB of LecTec Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4. The small business issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and have;

- a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- c) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and

5. The small business issuer's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: November 14, 2005

/s/ Alan C. Hymes, M.D.

Alan C. Hymes, M.D.
Chief Executive Officer

CERTIFICATION PURSUANT TO
#18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of LecTec Corporation (the "Company") on Form 10-QSB for the quarter ended September 30, 2005 as filed with the Securities and Exchange Commission (the "Report"), I, Alan C. Hymes, M.D., Chief Executive Officer of the Company, certify, pursuant to #18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Alan C. Hymes, M.D.

Alan C. Hymes, M.D.
Chief Executive Officer
(principal executive and financial
officer)
November 14, 2005