

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, 2000.

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____
to _____

Commission file number: 0-16159

LECTEC CORPORATION

(Exact name of Registrant as specified in its charter)

Minnesota

41-1301878

(State or other jurisdiction of
incorporation or organization)

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

10701 Red Circle Drive, Minnetonka, Minnesota

55343

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (952) 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 13, 2001 was 3,915,676 shares.

LECTEC CORPORATION

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2000

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

Item 1.	Condensed Consolidated Financial Statements and Notes to Consolidated Financial Statements (unaudited)	I-1
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	I-7
Item 3.	Quantitative and Qualitative Disclosure About Market Risk	I-10

PART II - OTHER INFORMATION

Item 1.	Legal Proceedings	II-1
Item 2.	Changes in 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 and Reports on Form 8-K	II-1
	Signature Page	II-3
	Exhibit Index	II-4

PART I - FINANCIAL INFORMATION

ITEM 1- FINANCIAL STATEMENTS AND NOTES TO FINANCIAL STATEMENTS

LECTEC CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

<TABLE>
<CAPTION>

	December 31, 2000	June 30, 2000
	----- (Unaudited)	-----
<S>	<C>	<C>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 285,620	\$ 100,171
Trade receivables and other, net of allowances of \$521,715 December 31, 2000 and June 30, 2000	2,190,207	2,645,710
Inventories		
Raw materials	1,765,434	1,649,544
Work-in-process	40,323	23,201
Finished goods	487,542	574,941
	-----	-----
	2,293,299	2,247,686
Prepaid expenses and other	410,868	242,543
	-----	-----
Total current assets	5,179,994	5,236,110
PROPERTY, PLANT AND EQUIPMENT - AT COST		
Land	247,731	247,731
Building and improvements	1,968,384	1,879,006
Equipment	5,174,453	5,080,180
Furniture and fixtures	414,857	414,857
	-----	-----
	7,805,425	7,621,774
Less accumulated depreciation	4,877,352	4,582,686
	-----	-----
	2,928,073	3,039,088
OTHER ASSETS		
Patents and trademarks, less accumulated amortization of \$1,327,067 and \$1,293,871 at December 31, 2000 and June 30, 2000	251,944	199,351
	-----	-----
	\$ 8,360,011	\$ 8,474,549
	=====	=====

</TABLE>

See accompanying notes to the condensed consolidated financial statements.

I - 1

LECTEC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS - CONTINUED

<TABLE>
<CAPTION>

	December 31, 2000	June 30, 2000
	----- (Unaudited)	-----
<S>	<C>	<C>
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Note payable to bank	\$ 343,325	\$ 837,542
Current maturities of long-term obligations	24,125	22,562
Accounts payable	2,795,212	1,910,551
Accrued expenses	766,877	792,894
Customer deposits	150,000	160,000
	-----	-----
Total current liabilities	4,079,539	3,723,549
LONG-TERM OBLIGATIONS, LESS CURRENT MATURITIES	838,718	31,184
COMMITMENTS AND CONTINGENCIES	--	--
SHAREHOLDERS' EQUITY		
Common stock, \$.01 par value: 15,000,000 shares authorized; 3,915,676 shares and 3,904,465 shares issued		

and outstanding at December 31, 2000 and June 30, 2000	39,157	39,045
Additional paid-in capital	11,332,829	11,316,260
Accumulated other comprehensive income	--	4,845
Accumulated deficit	(7,930,232)	(6,640,334)
	-----	-----
	3,441,754	4,719,816
	-----	-----
	\$ 8,360,011	\$ 8,474,549
	=====	=====

</TABLE>

See accompanying notes to the condensed consolidated financial statements.

I - 2

LECTEC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

<TABLE>
<CAPTION>

	Three months ended December 31,		Six months ended December 31,	
	2000	1999	2000	1999
<S>	<C>	<C>	<C>	<C>
Net sales	\$ 4,056,484	\$ 3,299,705	\$ 8,245,378	\$ 6,308,457
Cost of goods sold	2,697,711	2,236,691	5,252,574	4,306,162
	-----	-----	-----	-----
Gross profit	1,358,773	1,063,014	2,992,804	2,002,295
Operating expenses				
Sales and marketing	1,092,232	863,655	2,294,571	1,598,700
General and administrative	681,209	688,783	1,459,907	1,247,873
Research and development	225,657	310,202	441,523	579,964
	-----	-----	-----	-----
	1,999,098	1,862,640	4,196,001	3,426,537
	-----	-----	-----	-----
Loss from operations	(640,325)	(799,626)	(1,203,197)	(1,424,242)
Other income (expenses)				
Interest expense	(40,128)	(992)	(72,919)	(2,076)
Other, net	(11,543)	5,451	(13,782)	27,869
	-----	-----	-----	-----
Loss before income taxes	(691,996)	(795,167)	(1,289,898)	(1,398,449)
Income taxes	--	--	--	--
	-----	-----	-----	-----
Net loss	\$ (691,996)	\$ (795,167)	\$ (1,289,898)	\$ (1,398,449)
	=====	=====	=====	=====
Net loss per share - basic and diluted	\$ (0.18)	\$ (0.20)	\$ (0.33)	\$ (0.36)
	=====	=====	=====	=====
Weighted average shares outstanding - basic and diluted	3,908,364	3,881,352	3,906,415	3,878,914
	=====	=====	=====	=====

</TABLE>

See accompanying notes to the condensed consolidated financial statements.

I - 3

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

<TABLE>
<CAPTION>

Six Months Ended December 31,

	2000	1999
	-----	-----
<S>	<C>	<C>
Cash flows from operating activities:		
Net loss	\$ (1,289,898)	\$ (1,398,449)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	327,862	473,902
Changes in operating assets and liabilities:		
Trade and other receivables	455,503	385,280
Inventories	(45,613)	(151,339)
Prepaid expenses and other	(184,247)	(70,586)
Accounts payable	884,661	1,419
Accrued expenses and other	(36,016)	22,663
	-----	-----
Net cash provided by (used in) operating activities	112,252	(737,110)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(183,651)	(247,204)
Investment in patents and trademarks	(85,789)	(44,035)
Proceeds from sale of investments	11,076	--
	-----	-----
Net cash used in investing activities	(258,364)	(291,239)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock	16,681	26,815
Net repayments of line of credit	(494,217)	--
Proceeds from long-term borrowing	820,000	--
Repayment of long-term obligations	(10,903)	--
	-----	-----
Net cash provided in financing activities	331,561	26,815
	-----	-----
Net increase (decrease) in cash and cash equivalents	185,449	(1,001,534)
Cash and cash equivalents at beginning of period	100,171	1,022,025
	-----	-----
Cash and cash equivalents at end of period	\$ 285,620	\$ 20,491
	=====	=====

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the period for:

Interest expense	\$ 68,548	\$ 2,137
Income taxes	2,000	--

</TABLE>

See accompanying notes to the condensed consolidated financial statements.

I - 4

LECTEC CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) GENERAL

The accompanying condensed 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 condensed consolidated 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 its Annual Report on Form 10-K and its Annual Report to Shareholders for the fiscal year ended June 30, 2000. The interim condensed consolidated 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 PER SHARE

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 987,084 and 1,093,443 shares of common stock with a weighted average exercise price of \$5.77 and \$6.35 were outstanding during the six months ended December 31, 2000 and 1999, but were excluded because they were antidilutive.

(3) COMPREHENSIVE INCOME (LOSS)

For the quarter and six months ended December 31, 2000 there were no items which the Company is required to recognize as components of comprehensive income (loss), therefore comprehensive income (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,		Six months ended December 31,	
	2000	1999	2000	1999
Therapeutic consumer products	\$2,501,732	\$ 919,555	\$4,986,215	\$1,782,734
Conductive products	1,553,082	1,927,578	3,103,727	3,504,361
Medical tape products	1,670	452,572	155,436	1,021,362
	-----	-----	-----	-----
	\$4,056,484	\$3,299,705	\$8,245,378	\$6,308,457
	=====	=====	=====	=====

I - 5

(5) NOTE PAYABLE TO BANK

In November 1999, the Company entered into a secured line of credit with a maximum borrowing of \$2,000,000. In September 2000, the line of credit was increased to allow borrowing of up to \$2,800,000. The credit agreement expires in November 2001 and includes interest computed at the prime rate plus three percentage points. The line of credit is secured by the Company's receivables, inventory and equipment. Borrowings outstanding on the line of credit as of December 31, 2000, were \$343,325. 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. The Company was in compliance with all covenants as of December 31, 2000.

(6) LONG-TERM OBLIGATION

In December 2000, the Company entered into a mortgage agreement with gross proceeds of \$820,000. The principal balance of the mortgage is due in December 2002. Monthly payments of interest are computed at the prime rate plus five percentage points (effective rate of 14.5% at December 31, 2000). The mortgage is secured by the Company's real property.

(7) AGREEMENT TO SELL ASSETS

In November 2000, the Company entered into an agreement with the Ludlow Company LP (Ludlow) and Sherwood Services AG (Sherwood), pursuant to which Ludlow and Sherwood will purchase the Company's diagnostic electrode and electrically conductive adhesive hydrogel business assets which are used to produce the Company's conductive products. Under the agreement, the Company will receive \$7,250,000 in cash upon closing of the transaction, subject to adjustment for changes in the net assets at the time of closing. The agreement is subject to approval by the shareholders of the Company and other customary closing conditions. The Company anticipates that the closing will occur in March 2001 immediately following its Annual Meeting of Shareholders.

(8) INCOME TAXES

The provision for income taxes for the three months and six months ended December 31, 2000, has been offset principally by a valuation allowance for deferred taxes.

I - 6

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, 2000 AND 1999

RESULTS OF OPERATIONS

Net sales for the second quarter of fiscal 2001 were \$4,056,484 compared to net sales of \$3,299,705 for the second quarter of fiscal 2000, an increase of 22.9%. The increase was primarily the result of increased therapeutic consumer product sales which more than offset decreased conductive and medical tape sales. Therapeutic consumer product sales increased by 172.1% from \$919,555 to \$2,501,732 while conductive product sales decreased by 19.4% from \$1,927,578 to \$1,553,082 and medical tape product sales decreased by 99.6% from \$452,572 to \$1,670. The therapeutic consumer product sales increase was primarily the result of sales of the new acne product to Johnson & Johnson Consumer Products Worldwide as well as sales of the new vapor product to Novartis Consumer Health, Inc. The decrease in conductive product sales was primarily the result of the absence of a sales promotion offered to a major customer in the prior year, and softening customer demand. The Company expects conductive product sales to decrease in the remainder of fiscal 2001 due to the expected sale of assets used to produce the conductive products. The decrease in medical tape product sales was primarily due to a plan adopted by the Company at the end of fiscal 2000 to exit the medical tape business. The Company expects minimal tape sales in the remainder of fiscal 2001 as remaining inventories are liquidated.

Net sales for the first six months of fiscal 2001 were \$8,245,378 compared to net sales of \$6,308,457 for the first six months of fiscal 2000, an increase of 30.7%. The increase was primarily the result of increased therapeutic consumer product sales which more than offset decreased conductive and medical tape sales. Therapeutic consumer product sales increased by 179.7% from \$1,782,734 to \$4,986,215 while conductive product sales decreased by 11.4% from \$3,504,361 to \$3,103,727 and medical tape product sales decreased by 84.8% from \$1,021,362 to \$155,436. The therapeutic consumer product sales increase was primarily the result of sales of the new acne product to Johnson & Johnson Consumer Products Worldwide as well as sales of the new vapor product to Novartis Consumer Health, Inc. The decrease in conductive product sales was primarily the result of the absence of a sales promotion offered to a major customer in the prior year, and softening customer demand. The decrease in medical tape product sales was primarily due to a plan adopted by the Company at the end of fiscal 2000 to exit the medical tape business.

Gross profit for the second quarter of fiscal 2001 was \$1,358,773 compared to \$1,063,014 for the second quarter of fiscal 2000, an increase of 27.8%. Gross profit as a percent of net sales for the second quarter of fiscal 2001 was 33.5% compared to 32.2% for the second quarter of fiscal 2000. The slight improvement in gross profit for the quarter resulted primarily from an increase of approximately \$606,000 in gross profit related to increased sales volume and the favorable impact of a change in the sales mix toward higher-margin therapeutic consumer products. These items more than offset a decrease of approximately \$150,000 in gross profit related to the costs associated with resolving a packaging issue that occurred in the current quarter, as well as, a decrease of approximately \$99,000 in gross profit related to increased labor costs associated with higher production volumes and increased overtime related to the production of therapeutic patch products.

Gross profit for the first six months of fiscal 2001 was \$2,992,804 compared to \$2,002,295 for the first six months of fiscal 2000, an increase of 49.5%. Gross profit as a percent of net sales for the first six months of fiscal 2001 was 36.3% compared to 31.7% for the first six months of fiscal 2000. The increase in gross profit for the six months resulted primarily from an increase of approximately \$1,285,000 in gross profit related to increased sales volume and the favorable impact of a change in the sales mix toward higher-margin therapeutic consumer products. These items more than offset the decrease of approximately \$150,000 in gross profit related to the costs associated with resolving a packaging issue that occurred in the current six months, as well as, a decrease of approximately \$254,000 in gross profit related to labor costs associated with higher production volumes and increased overtime related to the production of therapeutic patch products.

Sales and marketing expenses were \$1,092,232 and \$863,655 during the second quarters of fiscal 2001 and 2000, and as a percentage of net sales, were 26.9% and 26.2% respectively. The

I - 7

increase in sales and marketing expenses for the quarter was primarily due to an increase of \$172,000 in media advertising expenses related to a TV ad campaign for TheraPatch vapor products and an increase of \$118,000 in cooperative advertising expenses which more than offset a decrease of \$80,000 in retail slotting fees. The Company anticipates that sales and marketing expenses as a percent of sales for the remainder of fiscal 2001 will be comparable to the second quarter of fiscal 2001 due to marketing programs associated with the TheraPatch product line.

Sales and marketing expenses were \$2,294,571 and \$1,598,700 during the first six months of fiscal 2001 and 2000, and as a percentage of net sales, were 27.8% and 25.3%. The increase in sales and marketing expenses for the first six months was primarily due to an increase of \$622,000 in media advertising expenses related to ad campaigns for TheraPatch products and an increase of \$112,000 in cooperative advertising expenses which more than offset a decrease of \$140,000 in retail slotting fees.

General and administrative expenses were \$681,209 and \$688,783 during

the second quarters of fiscal 2001 and 2000, and as a percentage of net sales, were 16.8% and 20.9% respectively. During the first six months of fiscal 2001 and 2000 general and administrative expenses were \$1,459,907 and \$1,247,873, and as a percentage of net sales, were 17.7% and 19.8% respectively. The Company anticipates that general and administrative expenses as a percent of sales for the remainder of fiscal 2001 will be comparable to the first six months of fiscal 2001.

Research and development expenses for the second quarters of fiscal 2001 and 2000 were \$225,657 and \$310,202, and as a percentage of net sales, were 5.6% and 9.4%. For the first six months of fiscal 2001 and 2000 research and development expenses were \$441,523 and \$579,964, and as a percentage of net sales, were 5.4% and 9.2%. The Company anticipates that research and development expenses as a percent of sales for the remainder of fiscal 2001 will increase due to additional headcount and other increased costs associated with testing of products under development.

Interest expense increased in the second quarter of fiscal 2001 to \$40,128 from \$992 in the second quarter of fiscal 2000. Interest expense increased in the first six months of fiscal 2001 to \$72,919 from \$2,076 in the first six months of fiscal 2000. Both of the fiscal 2001 increases resulted primarily from interest expense associated with increased borrowings under the line of credit. Other income (expense), decreased in the second quarter of fiscal 2001 to net expense of \$11,543 from other income of \$5,451 in the second quarter of fiscal 2000. Other income (expense), decreased in the first six months of fiscal 2001 to net expense of \$13,782 from other income of \$27,869 in the first six months of fiscal 2000. Both of the fiscal 2001 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 \$691,996 in the second quarter of fiscal 2001 compared to a loss before income taxes of \$795,167 for the second quarter of fiscal 2000. The Company recorded a loss before income taxes of \$1,289,898 in the first six months of fiscal 2001 compared to a loss before income taxes of \$1,398,449 for the first six months of fiscal 2000. The decrease in loss for the current year second quarter and first six months was primarily the result of increased gross profit that resulted from increased sales volume, a shift in the sales mix toward higher-margin therapeutic consumer products and the exit from the medical tape business. The increased gross profit more than offset an increase in operating expenses related to advertising expenses related to retail sales of the Company's TheraPatch products.

The provision for income taxes in the second quarter and first six months of fiscal 2001 and 2000 has been offset principally by a valuation allowance for deferred taxes.

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

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents increased by \$185,449 to \$285,620 during the first six months of fiscal 2001. Accounts receivable decreased by \$470,370 to \$2,172,510 during the first six months of fiscal 2001. The higher accounts receivable balance at June 30, 2000 was primarily due to significant initial

I - 8

sales, with extended terms, to a TheraPatch customer in the fourth quarter of fiscal 2000. Inventories increased by \$45,613 to \$2,293,299. Accounts payable of \$2,795,212 at December 31, 2000 increased by \$884,661 during the first six months primarily due to increased payables related to increased manufacturing production and increased advertising expenses related to the TheraPatch product line. Capital spending for manufacturing equipment and plant improvements totaled \$183,651 during the first six months of fiscal 2001. The Company entered into a purchase commitment for production machinery in the amount of \$154,482 during the first six months of fiscal 2001. This purchase commitment will be fulfilled by the end of fiscal year 2001.

The Company had working capital of \$1,100,455 and a current ratio of 1.3 at December 31, 2000 compared to working capital of \$1,512,561 and a current ratio of 1.4 at June 30, 2000.

The Company finalized a \$2,000,000 asset-based line of credit in November, 1999. In September 2000, the line of credit was increased to allow borrowing of up to \$2,800,000. Borrowings outstanding on the line of credit were \$343,325 as of December 31, 2000. The Company was in compliance with all covenants as of December 31, 2000.

In December 2000, the Company entered into a mortgage agreement with gross proceeds of \$820,000.

Management believes that existing cash and cash equivalents, internally-generated cash flow, the existing secured line of credit including the line of credit increase, the mortgage loan, and the pending sale of the Company's diagnostic electrode and electrically conductive adhesive hydrogel business assets will be sufficient to support anticipated operating and capital spending requirements during the remainder of fiscal 2001 and contribute to the

funding of longer-term growth and expansion of the business. Maintaining adequate levels of working capital depends in part upon the success of the Company's products in the marketplace, the relative profitability of those products and the Company's ability to control operating expenses. Funding of the Company's operations in future periods may require additional investments in the Company in the form of equity or debt. There can be no assurance that the Company will achieve desired levels of sales or profitability, or that future capital infusions will be available.

FORWARD-LOOKING STATEMENTS

From time to time, in reports filed with the Securities and Exchange Commission (including this Form 10-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; ability to satisfy funding requirements for operating needs, expansion or capital expenditures; and the matters discussed on our "Cautionary Statements" filed as Exhibit 99.1 to this form 10-Q.

I - 9

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 with the exception of TheraPatch sales to Canadian customers, precluding the need for foreign currency hedges. These Canadian sales have not been material.

I - 10

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

None.

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

Item No. -----	Item -----	Method of Filing -----
10.1	Loan Agreement and Promissory Note By and Between LecTec Corporation and Equity Holdings II dated December 21, 2000.	Filed herewith.
10.2	Asset Purchase Agreement dated November 17, 2000 by and among The Ludlow Company LP, Sherwood Services AG and LecTec Corporation.	Incorporated by reference to LecTec Corporation's Preliminary Proxy Statement

on Schedule
14-A filed
with the
Commission on
December 8,
2000.

99.1 Cautionary Statements.

Filed herewith.

II-1

(b) REPORTS ON FORM 8-K

On November 21, 2000 the Company filed a report on Form 8-K in connection with the signing of an Asset Purchase Agreement dated November 17, 2000 by and among The Ludlow Company LP, Sherwood Services AG and LecTec Corporation.

II-2

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 14, 2001 /s/ Rodney A. Young

Rodney A. Young, Chief Executive Officer
& President

Date February 14, 2001 /s/ Douglas J. Nesbit

Douglas J. Nesbit, Chief Financial Officer
& Secretary (Principal Financial Officer)

II-3

EXHIBIT INDEX

Exhibits

- 10.1 Loan Agreement and Promissory Note By and Between LecTec Corporation and Equity Holdings II dated December 21, 2000.
- 10.2 Asset Purchase Agreement dated November 17, 2000 by and among The Ludlow Company LP, Sherwood Services AG and LecTec Corporation (incorporated by reference to LecTec Corporation's Preliminary Proxy Statement on Schedule 14-A filed with the Commission on December 8, 2000).
- 99.1 Cautionary Statements.

II-4

LOAN AGREEMENT

THIS AGREEMENT is entered into this 21st day of December, 2000, between LecTec Corporation, a Minnesota corporation (the "Borrower"), and Equity Holdings II, a Minnesota general partnership, ("Lender"). The parties hereto agree as follows:

ARTICLE I.

Definitions

Section 1.01 Definitions. For 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 generally accepted accounting principles.

"Advance" means an advance of funds by Lender pursuant to Article II.

"Agreement" means this Loan Agreement.

"Event of Default" has the meaning specified in Section 6.01.

"Improvements" means the building and improvements constructed on the Property.

"Leases" means any lease of all or a portion of the Property and Improvements now or subsequently executed.

"Loan" has the meaning specified in Section 2.01.

"Loan Documents" means this Agreement, the Note, the Mortgage and all other documents and certificates reasonably requested by Lender in connection with the Loan transaction.

"Mortgage" has the meaning specified in Section 3.01(e).

"Note" has the meaning specified in Section 2.03.

"Obligations" means each and every debt, guaranty, liability, and obligation of every type or description which the Borrower may now or at any time owe to Lender, whether now existing or hereafter arising, direct or indirect, due or to become due, absolute or contingent, primary or secondary, liquidated or unliquidated, independent, joint, several, or joint and several.

"Property" means that certain real estate located at 10701 Red Circle Drive, Minnetonka, Minnesota which is more fully described on Exhibit A attached to the Mortgage and the improvements constructed thereon.

"Title Company" means Chicago Title Insurance Company.

"Title Policy" has the meaning specified in Section 3.01(g).

Additional Definitions may be found elsewhere in this Agreement.

ARTICLE II.

Amount and Terms of Loan

Section 2.01 Amount and Term of Lender's Commitment. Borrower agrees to borrow from Lender and Lender agrees to lend to Borrower on or before December 31, 2000, the amount of \$820,000 upon the terms and conditions hereof (the "Loan"), which sums shall be disbursed in accordance with this Agreement

and used solely for business purposes.

Section 2.02 Making the Loans. Each Advance shall be made by Lender to the Borrower in satisfaction of all conditions set forth herein. The Borrower shall be obligated to repay all Advances notwithstanding the fact that the person requesting the same was not authorized by Borrower to do so.

Section 2.03 Note. The obligation to repay the Loan together with interest and other charges thereon shall be evidenced by a Promissory Note of the Borrower payable to the order of Lender in a form acceptable to Lender dated the effective date of this Agreement (the "Note"). Interest on the Note shall accrue on the unpaid principal balance advanced and on any past due payments thereon at the annual rate of 5.0 percentage points above the Base Rate as hereinafter defined. The interest rate and payment amount shall change from time to time as the Base Rate changes. The term "Base Rate" means the highest Prime Rate of Interest published by the Wall Street Journal. If the Wall Street Journal discontinues the public announcement of Prime Rates of Interest for any reason, Lender shall set its own Base Rate and shall so notify Borrower.

2

Lender may lend to its customers at rates that are equal to, above or below the Base Rate. Interest will begin to accrue on the date of the first advance.

The principal balance which shall not exceed \$820,000 shall become due and payable in full on or before December 21, 2002. Monthly payments of interest only shall commence on January 21, 2001 and shall continue on the 21st day of each month thereafter until December 21, 2002, at which time the entire balance of principal and accrued interest shall become due and payable in full. Payments received by Lender more than 15 days after their due date shall incur a late payment penalty in the amount of 5% of each such payment which shall become immediately due.

Section 2.04 Payment, Balance and Setoff. All payments of principal, interest and other charges under the Note, and of all amounts hereunder shall be made to Lender in accordance with the terms of the Note in immediately available funds. The Borrower agrees that the amount shown in the books and records of Lender as being outstanding shall be prima facie evidence of the outstanding principal amount of the Note.

Section 2.05 Use of Proceeds. The Borrower shall use the proceeds of the Advance only for general business purposes.

Section 2.06 Proposal Fee. The Borrower shall pay to Lender a Proposal Fee of 1% of the amount due upon closing. Borrower has paid Lender \$10,000 which will be credited to Borrower at closing.

Section 2.07 Prepayment. The Loan may be prepaid in full at any time. No partial prepayments shall be allowed. The prepayment amount shall include all accrued interest, costs advanced by Lender, the full principal balance and all scheduled interest payments for the remaining term of the Loan.

ARTICLE III.

Conditions of Lending

Section 3.01 Required Documents. The initial advance of credit under the Loan shall be subject to the condition precedent that Lender shall have received prior thereto all of the following, in form and substance satisfactory to Lender:

(a) The Note, properly executed on behalf and in the name of the Borrower, in a form acceptable to Lender.

3

(b) All financing statements and other writings, properly executed, which are deemed by Lender to be necessary or desirable to grant Lender a perfected security interest on the personal property described in the Mortgage.

(c) Certificates of insurance covering the Property and Improvements and certificates of all other insurance including without limitation, builders risk insurance coverage, hazard insurance and comprehensive general public liability insurance coverage, and flood hazard insurance if the Property lies within a federally identified flood hazard area, as required by Section 5.03 or by the terms of the Mortgage, in such companies as shall be reasonably acceptable to Lender, which certificates shall name Lender as loss payee and Mortgagee.

(d) A Certificate of Incorporation and a current Certificate of Good Standing for the Borrower issued by the Minnesota Secretary of State.

(e) A Combination Real Estate Mortgage, Security Agreement, Fixture Financing Statement and Assignment of Leases and Rents in a form acceptable to Lender ("Mortgage") properly executed by the Borrower.

(f) An opinion of counsel to the Borrower in a form acceptable to Lender.

(g) A mortgagee's Title Policy issued by the Title Company to Lender in the amount of \$820,000, containing such endorsements as Lender deems necessary, insuring that the Mortgage constitutes a valid first lien on the Property, free and clear of all standard exceptions, including mechanics' liens and matters disclosed by a survey and all other exceptions not previously approved by Lender, and subject only to permitted encumbrances acceptable to Lender.

(h) Letters from the City of Minnetonka, Minnesota confirming that the Property is properly zoned for its intended use, that all utilities necessary for the operation of the Improvements are available, and such other evidence as Lender may require showing that all building and other permits have been obtained, and that the Property and all Improvements and the operation thereof will comply with all applicable laws, codes, rules and regulations, including those relating to zoning and environmental matters.

(i) A survey of the Property certified to Lender by a licensed, registered land surveyor and incorporating the legal description of the Property, showing the location of all points and lines referred to in, the legal description, the location of all Improvements, the location of all utilities to which the Improvements connect, the location of all easements and encroachments onto or from the Property that

4

are visible on the Property, known to the surveyor preparing the survey or of record, identifying easements or record by recording data.

(j) An appraisal of the Property satisfactory to Lender prepared by an independent appraiser approved by Lender demonstrating that the Property has an aggregate value of not less than \$1,640,000.

(k) True, complete and correct copies of the Articles of Incorporation and the Bylaws of the Borrower and all amendments thereto and modifications thereof, together with a certificate of the Secretary of the Borrower containing resolutions of the Borrower authorizing the execution and delivery of this Agreement and all other agreements, instruments and other documents which are required to be executed by the Borrower in connection with the Loan contemplated hereby, which certificate shall be in a form reasonably acceptable to Lender's counsel.

(l) An Environmental Site Assessment Phase I Report (the "Phase I") from an environmental engineer acceptable to Lender, in form and substance satisfactory to Lender, addressed to Lender, and any additional environmental related tests and reports recommended by the Phase I or deemed necessary by Lender.

(m) Such other documents as may be reasonably requested by Lender.

Section 3.02 Additional Requirements. As additional requirements and conditions of making the Loan it is agreed that Borrower shall be responsible for the payment of all costs incurred by Lender in relation to the Loan

including attorney fees incurred in preparation of the Loan Documents.

ARTICLE IV.

Representations and Warranties

The Borrower represents and warrants to Lender as follows:

Section 4.01 Existence and Power. The Borrower is a corporation created and existing and in good standing under the laws of the State of Minnesota, 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, and has all requisite power and authority to execute and deliver and to perform all of its obligations under this Agreement, the Note, the Mortgage and all other Loan Documents and writings contemplated hereby.

5

Section 4.02 Authorization. The execution, delivery and performance by the Borrower of this Agreement, the Note, the Mortgage and all other Loan Documents and writings contemplated hereby have been duly authorized by all requisite action and do and will not (a) require any consent or approval of any person or governmental authority, (b) violate any law, rule, regulation, order, writ, injunction or decree, or the Articles of Incorporation or Bylaws of the Borrower, (c) result in a breach of or constitute a default under any contract, agreement or other writing to which the Borrower is a party or by which the Borrower or any property of the Borrower may be bound or affected, or (d) result in or require the creation or imposition of, any mortgage, security interest or other interest, encumbrance, claim or charge of any nature, except in favor of Lender, upon or with respect to any property of the Borrower.

Section 4.03 Legal Agreements. The Loan Documents constitute the legal, valid and binding obligations of the Borrower; and this Agreement and any other writings contemplated hereby constitute the legal, valid and binding obligations of the Borrower.

Section 4.04 Financial Statements. The Borrower has furnished financial statements to Lender which consist of its required 10Q filing with the Securities and Exchange Commission for the period ending September 30, 2000. Said statements and balance sheets fully and fairly reflect the financial condition of the Borrower.

Section 4.05 No Adverse Change. There has been no material adverse change in the business, property or condition (financial or otherwise) of the Borrower.

Section 4.06 Titles and Liens. The Borrower has good title to all of the property reflected in the latest balance sheet referred to in Sections 4.04 and 5.01, free and clear of all mortgages, security interests and other interests, encumbrances, claims and charges, except for liens permitted herein and covenants, restrictions, rights, easements and minor irregularities in title which do not materially interfere with the business or operations of the Borrower.

Section 4.07 Taxes. Borrower has filed all required tax returns (or obtained appropriate extensions for the filing thereof), has paid all due and payable taxes, assessments and other governmental charges levied or imposed upon it, or upon its income or profits or upon its property, and has made adequate provision for the payment of such taxes, assessments and other charges accruing but not yet due and payable.

6

Section 4.08 Litigation. There is no pending or threatened notice, claim, litigation, proceeding or investigation against or affecting the Borrower, or any of its property, whether or not covered by insurance, that would involve the payment by Borrower of \$25,000 or more in the aggregate or would otherwise have a material adverse effect on the financial condition,

business, prospects, property or operations of Borrower, and there is no basis for any such order, notice, claim, litigation, proceeding or investigation.

Section 4.09 No Agricultural Uses. The Borrower will not allow the Property to be used for any agricultural activities so as to allow the Farm Mediation Act to apply to this loan or any collateral pledged to Lender.

Section 4.10 Business Purpose. This Agreement and all writings contemplated hereby and the proceeds of the Advance are solely for business purposes and no funds will be used for personal, family or household purposes.

Section 4.11 Compliance with Zoning Ordinances and Similar Laws. The Improvements and the proposed use of the Improvements comply and will comply with all governmental laws, regulations, and requirements, zoning ordinances and regulations of all governmental bodies exercising jurisdiction over the Property.

Section 4.12 Hazardous or Toxic Substances. To Borrower's knowledge after reasonable investigation, and except as set forth on the Phase I Report dated December 8, 2000 prepared by Peer Environmental & Engineering Resources, Inc., (i) no person or entity has caused or permitted materials to be stored, deposited, treated, recycled or disposed of on, under or at the Property, which materials, if known to be present, would require clean-up, removal or some other remedial action under Environmental Laws; (ii) there have never been tanks or other facilities on, under or at the Property which contained materials which, if known to be present in soils or groundwater, would require clean-up, removal or some other remedial action under Environmental Laws; (iii) there are no conditions existing currently or which will exist during the term of this Agreement which subject Borrower to damages, penalties, injunctive relief or clean-up costs under Environmental Laws or which require or are likely to require clean-up, removal, remedial action or other response by Borrower pursuant to Environmental Laws; (iv) Borrower is not subject to any judgment, decree, order or citation relating to or arising out of any Environmental Laws; and (v) Borrower shall have all permits, licenses and approvals required under Environmental Laws. As used in this Agreement the term "Environmental Laws" means all federal, state and local laws including statutes, regulations, ordinances, codes, rules or other governmental restrictions and requirements relating to the discharge of air pollutants, water pollutants or process waste water or otherwise

7

relating to the environment or hazardous substances, including but not limited to, the Minnesota Petroleum Tank Release Cleanup Act, the Minnesota Environmental Response and Liability Act, the Federal Solid Waste Disposal Act, the Federal Clean Air Act, the Federal Clean Water Act, the Federal Resource Conservation and Recovery Act of 1976, the Federal Comprehensive Environmental Responsibility, Cleanup and Liability Act of 1980, regulations of the Environmental Protection Agency, regulations of the Nuclear Regulatory Agency, and regulations of any state department of natural resources or state environmental protection agency now or at any time hereafter in effect.

Section 4.13 Availability of Utilities. All utility services necessary for the proper operation of the Improvements and the existing improvements on the Property for their intended purposes are available at the Property, at standard utility rates and hook-up charges, including water supply, storm and sanitary sewer facilities, gas, electricity and telephone facilities.

ARTICLE V.

Covenants

So long as the Note shall remain outstanding, the Borrower shall comply with the following requirements:

Section 5.01 Financial Statements and Other Information. Borrower shall deliver to Lender, in form and substance satisfactory to Lender:

(a) Promptly after sending, making available or filing the same, copies of all Federal tax returns.

(b) As soon as available, and in any event within 90 days after the end of each fiscal year, annual financial statements in a format acceptable to Lender.

(c) Quarterly rent rolls for the Property setting forth the names of all tenants and the terms of all leases or rental agreements.

(d) Such other information respecting the financial condition, business and property of the Borrower as Lender may from time to time reasonably request.

Section 5.02 Taxes and other Claims. Borrower shall file when due (within any period covered by an attainable extension) all required tax returns, shall pay when due all taxes, assessments and other governmental charges levied or

8

imposed upon it upon its income or profits, or upon any of its property, and shall pay when due all lawful claims for labor, materials and supplies which, if unpaid, might become a lien or charge upon any property of Borrower; provided, that 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 a proper reserve has been established in accordance with generally accepted accounting principles.

Section 5.03 Insurance. Borrower shall obtain and maintain insurance with insurers that are reasonably acceptable to Lender, in such amounts and with such coverages as are reasonably acceptable to Lender, including without limitation the following insurance coverages:

(a) All risk property insurance providing coverage against loss by fire, lightning and other hazards and risks customarily covered by standard extended coverage endorsement, including the cost of debris removal, together with a vandalism and malicious mischief endorsement, all in the amounts of not less than the full insurable value or full replacement cost of the Improvements, whichever is greater;

(b) Flood insurance in the maximum obtainable amount unless evidence satisfactory to Lender is provided that the entire Property lies entirely outside of a federally-identified flood hazard area or flood plain as defined by the Federal Insurance Administration;

(c) "Business interruption" insurance coverage in an amount reasonably acceptable to Lender;

(d) Commercial general liability insurance covering the legal liability of Borrower against claims for bodily injury, death or property damage occurring on, in or about the Property and Improvements, with coverage limits of at least \$1,000,000 for each occurrence and \$3,000,000 excess liability coverage; and

(e) Workers' compensation insurance as required by law and all other insurance coverages as are consistent with industry practice.

All insurance policies shall name Lender as mortgagee and a loss payee, shall be in an amount which shall be, in any event, sufficient to prevent the insured from becoming a co-insurer of any loss thereunder, and shall contain a provision whereby they cannot be cancelled except after 30 days' written notice to Lender. In the event the Borrower fails to pay any premium on any such insurance, Lender may do so, and the Borrower shall reimburse Lender for any

9

such payment on demand. Borrower hereby assigns to Lender all returned or unearned premiums that may be payable to the Borrower upon cancellation of any such policies for any reason and all proceeds of such insurance, and directs the insurers to pay Lender all such amounts. Borrower hereby grants Lender a limited power of attorney to endorse any check or other remittance payable to Borrower to collect such returned or unearned premiums and the proceeds of such

insurance, and any amount so collected may be applied by Lender to the Note or other obligations due Lender by the Borrower as Lender, in its discretion, deems appropriate.

Section 5.04 Corporate Existence. The Borrower shall preserve and maintain its corporate existence and all of its rights, privileges and franchises, and comply with all applicable laws and regulations.

Section 5.05 Nature of Business. The Borrower shall not engage in any line of business materially different from that presently engaged in by the Borrower.

Section 5.06 Permits and Licenses. Borrower shall obtain and maintain or cause to be obtained and maintained all permits and licenses necessary to operate its business on the Property.

Section 5.07 Due on Sale. Borrower shall not sell, convey, transfer, further mortgage or encumber or dispose of the Property or any interest therein without the prior written consent of Lender.

Section 5.08 Real Estate Taxes and Assessments. At any time Lender may require that, in addition to the monthly loan payments required under the Notes, Borrower shall pay to Lender with each such monthly loan payment one-twelfth of the annual amount of the real estate taxes and assessments assessed against the Property. Lender shall have no obligation to segregate said escrow payment. In the event that the escrow account is insufficient to pay the real estate taxes and assessments when due, Borrower shall immediately pay Lender amounts sufficient to allow for payment of the taxes and assessments when due.

Section 5.09 Indemnity. Borrower shall reimburse and indemnify Lender for any expenses, costs or claims which Lender may incur relating to its exercise of any rights under this Agreement or writings contemplated hereby. Such amounts shall be due and payable upon demand and shall bear interest at the rate specified in the Note. To the extent possible Lender will attempt to give Borrower notice five days prior to incurring expenses, however, the failure to give such notice shall not impair Borrower's obligation to reimburse and indemnify Lender. Borrower shall defend, indemnify and hold Lender harmless from and against

10

any and all liabilities arising from brokerage commissions or finder's fees in connection with the Property, including without limitation, the cost of attorneys' fees in connection therewith.

Section 5.10 Compliance with Laws and Requirements. Borrower agrees to comply at all times with all applicable restrictions, requirements, conditions, codes, ordinances, regulations and laws of all governmental bodies having jurisdiction over the Property.

Section 5.11 Notices to Lender. Borrower covenants and agrees to furnish to Lender (i) immediately upon receipt, copies of any correspondence, notice, pleading, citation, indictment, complaint, order, decree or other document from any source asserting or alleging a circumstance or condition which requires or may require a financial contribution by Borrower or a cleanup, removal, remedial action or other response by or on the part of Borrower under Environmental Laws or which seeks damages or civil, criminal or punitive penalties from Borrower for an alleged violation of Environmental Laws; and (ii) written notice of any condition or event which would make the warranties contained in Article IV inaccurate, as soon as Borrower becomes aware of such condition or event.

ARTICLE VI.

Events of Default, Rights and Remedies

Section 6.01 Events of Default. The occurrence of any of the following events shall constitute an "Event of Default":

(a) Default in the payment of any amount due under this Agreement, the Note or any other Obligation of the Borrower to Lender and the continuance of

such default for a period of 10 days; or

(b) Any statement, representation or warranty of Borrower to Lender at any time, including without limitation any statement, representation or warranty made in this Agreement or in any writing contemplated by this Agreement or otherwise furnished to Lender, shall prove to have been incorrect or misleading in any material respect when made; or

(c) Default in the performance or breach of any other covenant or agreement of Borrower contained in this Agreement, any writing contemplated by this Agreement or any other agreement with Lender, which defaults or breaches remain uncured for a period of thirty (30) days, or for a reasonable period after such thirty (30) day period if such default is curable but requires acts to be done or conditions to be remedied which cannot be cured or remedied within such thirty (30) day period and provided the Borrower commences to cure such default

11

within such thirty (30) day period and thereafter diligently and continuously attempts to cure such default within such reasonable period; or

(d) Borrower shall become insolvent, make an assignment for the benefit of creditors, apply for or consent to the application or suffer the appointment of any receiver, trustee or similar officer, die, or initiate or have initiated against it any act, process or proceeding under any insolvency, bankruptcy, dissolution, liquidation or similar law (provided that the filing of an involuntary petition in bankruptcy against Borrower, shall constitute an Event of Default only if the petition is not dismissed within 30 days after filing); or

(e) Any indebtedness in excess of \$25,000.00 under any other bond, debenture, note, other evidence of indebtedness or obligation of Borrower is declared due and payable prior to its expressed maturity by reason of default by any such party; or

(f) Borrower shall suffer a final judgment or other order for the payment of money in the amount of \$25,000 or more which becomes a lien on the Property, and the same shall not be released, vacated or fully bonded within a period of 45 days during which execution shall not be effectively stayed; or

(g) The issuance or levy of any writ, warrant, attachment, execution or similar process against, or the attachment of any tax lien to, any property of Borrower and shall not be released or fully bonded within thirty (30) days after its issue, levy or entry; or

(h) Occurrence of any event constituting an event of dissolution or liquidation of Borrower under applicable law; or

(i) The Improvements are materially damaged or destroyed by fire or other casualty and the same is not repaired expeditiously in accordance with the applicable provisions of the Mortgage; or

Section 6.02 Rights and Remedies. Upon the occurrence of an Event of Default or at any time thereafter until such Event of Default is cured to the written satisfaction of Lender, Lender may exercise any and all of the following rights and remedies:

(a) Lender may declare all principal, interest and other charges and amounts under the Note, this Agreement or under any writing evidencing any obligations of Borrower to Lender to be due and payable, whereupon the same shall become due and payable, without presentment, demand, protest or other notice of any kind, all of which are hereby expressly waived by Borrower.

12

(b) Lender may, without notice to Borrower or any other person, apply any and all money owing by Lender to the Borrower to the payment of principal, interest and other charges and amounts under the Note or this Agreement or under

any writing evidencing any Obligations of the Borrower to Lender.

(c) Lender may exercise and enforce its rights and remedies under the Loan Documents, any agreement or other writing securing any obligations of Borrower to Lender, the Uniform Commercial Code and any other applicable law.

(d) Lender may, by notice to the Borrower, declare its obligation to make Advances hereunder to be terminated, whereupon the same shall terminate.

ARTICLE VII.

Miscellaneous

Section 7.01 Waiver and Amendment. No provision, of this Agreement or any of the other Loan Documents can be waived, modified, amended, abridged, supplemented or terminated, except by a writing executed by Lender. A waiver shall be effective only in the specific instance and for the specific purpose given. No delay or failure by Lender to exercise any right or remedy shall be a waiver thereof, nor shall any single or partial exercise by Lender of any right or remedy preclude any other exercise thereof or the exercise of any other right or remedy. All rights and remedies of Lender under this Agreement and the other Loan Documents are cumulative and not exclusive.

Section 7.02 Costs and Uses. Borrower shall pay to Lender on demand all costs and expenses, including without limitation, reasonable attorneys' fees, incurred by Lender in connection with the preparation of the Loan Documents, and all costs and expenses, including without limitation, reasonable attorneys' fees, incurred by Lender in connection with any amendment and/or enforcement of the Loan Documents.

Section 7.03 Addresses. All notices, requests, demands and other communications provided for under this Agreement and the other Loan Documents shall be in writing and shall be delivered in person or deposited in the mail, postage prepaid, addressed as follows:

If to the Borrower: LecTec Corporation
 10701 Red Circle Drive
 Minnetonka, MN 55343
 Attn: President and CFO

13

With a Copy to: James L. Tucker III
 Dorsey & Whitney, LLP
 220 South Sixth Street
 Minneapolis, MN 55402-1498

If to Lender: Equity Holdings II
 7450 France Avenue South
 Suite 120
 Minneapolis, MN 55435
 Attn: Tim Cashin

or, as to each party, at such other address as shall 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 effective when actually delivered or deposited in the mail.

Section 7.04 Binding Effect and Assignment. This Agreement and the other Loan Documents shall be binding upon and inure to the benefit of the parties hereto and thereto and their respective successors and assigns, except that Borrower shall not have any right to assign any of their rights hereunder or thereunder or any interest herein or therein without the prior written consent of Lender. Lender reserves the right to transfer or sell all or a portion of its interest in the Loan and in connection therewith to disclose to any purchaser or potential purchaser of such interest any information furnished to Lender by Borrower (as long as such potential purchaser agrees to keep such information confidential) and to assign to any such purchaser all or a portion of Lender's rights and interests under the terms of this Agreement and the other Loan Documents. If any provision or application of this Agreement or the other Loan Documents is held unlawful or unenforceable in any respect, such illegality

or unenforceability shall not affect the other provisions or applications which can be given effect, and this Agreement and the other Loan Documents shall be construed as if the unlawful or unenforceable provision or application had never been contained herein or therein or prescribed hereby or thereby.

Section 7.05 Jurisdiction and Venue. Borrower consents to the personal jurisdiction of the state and federal courts located in the State of Minnesota in connection with any controversy related in any way to this Agreement or any of the other Loan Documents, waives any argument that venue in such forums is not convenient, and agrees that any litigation initiated by Borrower against Lender in connection with this Agreement or any of 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.

14

Section 7.06 Headings. Article and Section headings in this Agreement are for convenience of reference only, and shall not constitute a part of this Agreement for any other purpose or a limitation of the scope of the particular Articles or Sections to which they refer.

Section 7.07 Governing Law. This Agreement and the other Loan Documents (except as otherwise stated therein), shall be governed by and construed in accordance with the laws of the State of Minnesota.

Section 7.08 Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be an original but all of which shall together constitute one instrument.

Section 7.09 Relationship of Parties. The relationship of the parties under this Agreement is that of lender and borrower and no joint venture, partnership or relationship of any other kind is intended, or is to be construed or implied, to have been created.

Section 7.10 Merger. This Agreement and the other Loan Documents contain all of the terms, conditions and covenants between the parties. Borrower is not relying on any representation or warranty of Lender except as expressly set forth herein.

15

IN WITNESS WHEREOF, the parties have executed this Agreement on the date first above written.

BORROWER:

LECTEC CORPORATION,
a Minnesota corporation

By /s/ Douglas Nesbit

Douglas Nesbit, its CFO

LENDER:

EQUITY HOLDINGS II

By /s/ Tim Cashin

Tim Cashin, Its Partner

16

PROMISSORY NOTE

\$820,000.00

Minneapolis, Minnesota
December 21, 2000

FOR VALUE RECEIVED, the undersigned Borrower promises to pay to the order of Equity Holdings II (the "Lender"), at its office in Edina, Minnesota, or at such other place as the holder of this Note may designate from time to time, the principal sum of \$820,000.00 which remains outstanding as shown in the records of the holder of this Note, as the case may be, and to pay interest on the outstanding balance hereof at the times and at the rates set forth below. This Note is secured by a Combination Real Estate Mortgage, Security Agreement, Fixture Financing Statement and Assignment of Leases and Rents dated the date hereof from the undersigned to Lender relating to certain property located in Minnetonka, Minnesota as more particularly described therein (as amended from time to time, the "Mortgage"). Lender may make additional subsequent advances at its discretion but at no time shall Lender advance an amount which would cause the unpaid principal balance of this Note to exceed \$820,000.00.

Interest on the Note shall accrue on the unpaid principal balance and on any past due payments thereon at the annual rate of 5.0 percentage points above the Base Rate as hereinafter defined. The interest rate and payment amount shall change from time to time as the Base Rate changes. The terms "Base Rate" means the highest Prime Rate of Interest published by the Wall Street Journal. If the Wall Street Journal discontinues the public announcement of Prime Interest Rates for any reason, Lender shall set its own Base Rate and shall so notify Borrower. Lender may lend to others at rates that are equal to, above or below the Base Rate. Interest will begin to accrue on the date of the first advance.

The remaining principal balance of this Note shall become due and payable in full on or before December 21, 2002. Monthly payments of interest only shall commence on January 21, 2001 and shall continue on the 21st day of each month thereafter until December 21, 2002, at which time the entire balance of principal and accrued interest shall become due and payable in full. Payments received by Lender more than 15 days after their due date shall incur a late payment penalty in the amount of 5% of each such payment which shall become immediately due.

Interest on this Note shall be calculated on the basis of actual days elapsed in a year of 360 days. All of the unpaid balance of this Note may be prepaid in full at any time. No partial prepayments shall be allowed. The prepayment amount shall include all accrued interest, costs advanced by Lender, the full principal balance and all scheduled interest payments for the remaining term of the Loan. Each monthly payment or prepayment shall be applied first to the payment of other charges under this

Note, second to the payment of interest accrued through the date of payment and third to the payment of principal under this Note.

In the event of any default in the payment of this Note and the continuance of such default for a period of 15 days, or the occurrence of an Event of Default under the terms of the Loan Agreement or any of the other "Loan Documents" (as such term is defined in the Loan Agreement), or of any other obligations of the undersigned to the holder of this Note; or in the event any of the undersigned or any maker, endorser, guarantor or surety of this Note or any other person providing security for this Note or for any guaranty for this Note shall become insolvent, make an assignment, make an assignment for the benefit of creditors, apply for or consent to the application or suffer the appointment of any receiver, trustee or similar officer, die, or initiate or have initiated against it any act, process or proceeding under any insolvency, bankruptcy, dissolution, liquidation or similar law (provided that the filing of an involuntary petition in bankruptcy against the undersigned, or any of the guarantors of this Note, shall constitute an event of default only if the petition is not dismissed within 30 days after filing); or a final judgment or other order for the payment of money in the amount of \$25,000 or more, or any writ, warrant, attachment, execution or similar process, shall be entered and become a lien on, issued or levied against, the Premises, or any part thereof and shall not be released, vacated or fully bonded within forty-five (45) days

after its entry, issue or levy; or the issuance or levy of any writ, warrant, attachment, execution or similar process against any property of any of the undersigned or any such maker, endorser, guarantor, surety or other person which is not released or fully bonded within a period of 30 days; or in the event that any statement, representation or warranty of any of the undersigned or any such maker, endorser, guarantor, surety or other person to any holder of this Note at any time shall prove to have been incorrect or misleading in any material respect when made; then in any such event the holder of this Note may, at its option, declare this Note to be immediately due and payable and thereupon this Note shall become due and payable for the entire unpaid principal balance of this Note plus accrued interest and other charges on this Note without any presentment, demand, protest or other notice of any kind.

Each of the undersigned and each endorser, guarantor and surety of this Note jointly and severally agree to pay this Note; guarantee payment of this Note; waive demand, presentment, protest, notice of protest, notice of dishonor and notice of nonpayment of this Note; consent to any extensions and renewals of this Note without notice; consent to the release of any of them by the holder of this Note with or without consideration or notice; exonerate the holder of this Note from any duty or obligation to make demand on anyone for payment of any security or delivery of any guaranty for this Note or to give notice to anyone of nonpayment thereof or to collect or sell the same; consent to the extension, renewal, exchange, subordination, surrender or release of any security for this Note by the holder of this Note with or without consideration or notice; agree that no act, omission or thing, except full payment of this Note, which but for this provision could act as a release or impairment of their liability, shall in any way release, impair or affect the liability of any of them; agree to promptly provide the holder of this Note from time to time with their financial statements and such

2

other information respecting their financial condition, business and property as the holder of this Note may request, in form and substance acceptable to the holder of this Note; agree that when or at any time after this Note becomes due the holder of this Note may offset or charge the full amount owing on this Note against any account then maintained by any of them with the holder of this Note without notice; agree to pay on demand all costs and expenses of the holder of this Note in connection with this Note and any security and guaranties for this Note, including without limitation reasonable attorneys' fees, plus interest on such amounts at the rate set forth in this Note; and consent to the personal jurisdiction of the state and federal courts located in the State of Minnesota in connection with any controversy related in any way to this Note or any security or guaranty for this Note, waive any argument that venue in such forums is not convenient, and agree that any litigation initiated by any of them against Lender or any other holder of this Note relating in any way to this Note or any security or guaranty for this Note shall be venued in either the District Court of Hennepin County, Minnesota, or the United States District Court, District of Minnesota, Fourth Division. Interest on any amount under this Note shall continue to accrue, at the option of the holder of this Note, until such holder receives final payment of such amount in collected funds in form and substance acceptable to such holder.

No waiver of any right or remedy under this Note shall be valid unless in writing executed by the holder of this Note, and any such waiver shall be effective only in the specific instance and for the specific purpose given. All rights and remedies of the holder of this Note shall be cumulative and may be exercised singly, concurrently or successively. The undersigned, if more than one, shall be jointly and severally liable under this Note, and the term "undersigned" wherever used in this Note, shall mean the undersigned or any one or more of them. This Note shall be governed by and construed in accordance with the laws of the State of Minnesota.

THE UNDERSIGNED REPRESENTS, CERTIFIES, WARRANTS AND AGREES THAT THE UNDERSIGNED HAS READ THIS NOTE IN ITS ENTIRETY AND UNDERSTAND ALL OF THE PROVISIONS OF THIS NOTE. THE UNDERSIGNED ALSO AGREES THAT THE COMPLIANCE BY ANY PRESENT OR FUTURE HOLDER OF THIS NOTE WITH THE EXPRESS PROVISIONS OF THIS NOTE SHALL CONSTITUTE GOOD FAITH AND SHALL BE CONSIDERED REASONABLE FOR ALL PURPOSES.

By /s/ Douglas Nesbit

Douglas Nesbit, its CFO

LECTEC CORPORATION
Quarterly Report on Form 10-Q
December 31, 2000

CAUTIONARY STATEMENTS FOR PURPOSES OF THE "SAFE HARBOR"
PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

The Private Securities Litigation Reform Act of 1995 provides public companies with a "safe harbor" from liability for forward-looking statements if those statements are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those contained in the forward-looking statements. The Company hereby identifies the following important factors which could cause the Company's actual results to differ materially from those contained in any forward-looking statement made by the Company from time to time in any report, proxy statement, registration statement or other written communication or in oral forward-looking statements made from time to time by the Company's offices or agents.

WE HAVE A HISTORY OF LOSSES AND WE EXPECT LOSSES TO CONTINUE FOR THE FORESEEABLE FUTURE

Although we have generated differing levels of revenue over the last several years, we have not had profitable operations. We expect to continue to incur losses for the foreseeable future. We have expended a substantial amount of our resources in sales and marketing efforts and researching and developing technology relating to our products.

We plan to increase our operating expenses as we continue to devote significant resources to developing our therapeutic consumer products business. We expect to incur substantial operating losses in the foreseeable future as we invest in our therapeutic consumer products business. Our losses may increase in the future, and even if we achieve our revenue targets, we may not be able to sustain or increase profitability on a quarterly or annual basis. The amount of future net losses, and the time required to reach profitability, are both highly uncertain. We cannot assure you that we will ever be able to achieve or sustain profitability.

OUR SUCCESS DEPENDS ON A SINGLE FAMILY OF PRODUCTS

We have adopted a strategy of focusing our efforts on our therapeutic consumer products business. As a result, our revenue and profitability depend on sales of our topical ointment-based products for the application of over-the-counter drugs. A reduction in demand for these products would have a material adverse effect on our business. We have relatively limited experience selling our therapeutic consumer products. Accordingly, we can not assure you that sales of our therapeutic consumer products represent long-term consumer acceptance of these products, or that the recent increase in therapeutic consumer products sales is indicative of future growth rates for sales of these products. The sustainability of current levels of therapeutic

consumer products sales and the future growth of such sales, if any, will depend on, among other factors:

- * continued consumer trial of our products;
- * generation of repeat consumer sales;
- * further development and sales of our TheraPatch brand name products;
- * development of further relationships with resellers of our products;
- * competition from substitute products;
- * effective consumer advertising.

We can not assure you that we will maintain or increase our current

level of therapeutic consumer products sales or profits in future periods.

OUR SUCCESS DEPENDS ON OUR RELATIONSHIPS WITH RESELLERS OF OUR PRODUCTS

A significant portion of the sales of our therapeutic consumer products are derived from agreements with other companies that act as resellers of our products. Under these agreements, our products are marketed and sold under another company's brand name and by another company's sales force. Our success depends in part upon our ability to enter into additional reseller agreements with new third parties while maintaining our existing reseller relationships. We believe our relationships with our existing third party resellers have been a significant factor in the success to date of our therapeutic consumer products business, and any deterioration or termination of these relationships would seriously harm our business.

OUR FUTURE SUCCESS DEPENDS ON OUR ABILITY TO MANAGE ANY GROWTH IN OUR THERAPEUTIC CONSUMER PRODUCTS BUSINESS

If we are successful in increasing the sales of our therapeutic consumer products we may be required to expand our operations, particularly in the areas of research and development, sales and marketing, and manufacturing. If we are required to expand our operations in these areas, those expansions will likely result in new and increased responsibilities for management personnel and place significant strain on our management, operating and financial systems and other resources. To accommodate any such growth and compete effectively, we will be required to implement improved information systems, procedures and controls, and to expand, train, motivate and manage our work force. Our future success will depend to a significant extent on the ability of our current and future management personnel to operate effectively both independently and as a group. We can not assure you that our personnel, systems, procedures and controls will be adequate to support our future operations.

We manufacture our therapeutic consumer products in quantities sufficient to satisfy our current level of sales. To meet any increases in sales, we may need to increase our production significantly beyond our present manufacturing capacity. Accordingly, we may be required to

increase our manufacturing capacities. We can not assure you that increasing our capacity can be accomplished on a profitable basis.

THE MARKET FOR OUR PRODUCTS IS COMPETITIVE AND WE MAY NOT HAVE THE RESOURCES REQUIRED TO COMPETE EFFECTIVELY

The markets for the therapeutic consumer products we sell are relatively new and therefore subject to rapid and significant change. We face significant competition in the development and marketing of these products. We can not assure you that we will be able to compete effectively in the sale of our products. Competitors in the United States and abroad are numerous and include, among others, major pharmaceutical and consumer product companies. Our competitors may succeed in developing technologies and products that are more effective than those we are developing and could render our therapeutic consumer products obsolete and noncompetitive. Many of our competitors have substantially greater financial and technical resources, marketing capabilities and regulatory experience. In addition, these companies compete with us in recruiting and retaining highly qualified personnel. As a result, we cannot assure you that we will be able to compete successfully with these organizations.

PATENTS AND OTHER PROPRIETARY RIGHTS PROVIDE UNCERTAIN PROTECTION OF OUR PROPRIETARY INFORMATION AND OUR INABILITY TO PROTECT A PATENT OR OTHER PROPRIETARY RIGHT MAY HARM OUR BUSINESS

The patent position of companies engaged in the sale of products such as ours is uncertain and involves complex legal and factual questions. Issued patents can later be held invalid by the patent office issuing the patent or by a court. We can not assure you that our patents will not be challenged, invalidated or circumvented or that the rights granted thereunder will provide us a competitive advantage. In addition, many other organizations are engaged in research and development of products similar to our therapeutic consumer products. Such organizations may currently have, or may obtain in the future, legally blocking proprietary rights, including patent rights, in one or more

products or methods under development or consideration by us. These rights may prevent us from commercializing new technology, or may require us to obtain a license from the organizations to use their technology.

We also rely on trade secrets and other unpatented proprietary information in the manufacturing of our therapeutic consumer products. To the extent we rely on confidential information to maintain our competitive position, there can be no assurance that other parties will not independently develop the same or similar information.

There has been substantial litigation regarding patent and other intellectual property rights in the consumer products industry. Litigation could result in substantial costs and a diversion of our effort, but may be necessary to enforce any patents issued to us, protect our trade secrets or know-how, defend against claimed infringement of the rights of others or determine the scope and validity of the proprietary rights of others. We can not assure you that third parties will not pursue litigation that could be costly to us. An adverse determination in any litigation could subject us to significant liabilities to third parties, require us to seek licenses from or pay royalties to third parties or prevent us from manufacturing or selling our products, any of which could have a material adverse effect on our business.

WE ARE SUBJECT TO REGULATION BY REGULATORY AUTHORITIES INCLUDING THE FDA WHICH MAY AFFECT THE MARKETING OF OUR PRODUCTS

The research, development, manufacture, labeling, distribution, marketing and advertising of our products, and our ongoing research and development activities, are subject to extensive regulation by governmental regulatory authorities in the United States and other countries. Failure to comply with regulatory requirements for marketing our products could subject us to regulatory or judicial enforcement actions, including, but not limited to, product recalls or seizures, injunctions, civil penalties, criminal prosecution, refusals to approve new products and suspensions and withdrawals of existing approvals. Currently, the majority of our therapeutic consumer products are regulated as over-the-counter products. We can not assure you that the FDA will continue to regulate these products as over-the-counter products. If the FDA changed its approach to regulating our products, we would be faced with significant additional costs and may be unable to sell some or all of our products. Any such change would have a material adverse effect on our business. Delays in obtaining regulatory approvals for any new products could have a material adverse effect on our business. Even if regulatory approval of a new product is granted, such approval may include significant limitations on the indicated uses of the product or the manner in which or conditions under which the product may be marketed.

WE MAY BE REQUIRED TO REDUCE OR ELIMINATE SOME OR ALL OF OUR SALES AND MARKETING EFFORTS OR RESEARCH AND DEVELOPMENT ACTIVITIES IF WE FAIL TO OBTAIN ADDITIONAL FUNDING THAT MAY BE REQUIRED TO SATISFY OUR FUTURE CAPITAL EXPENDITURE NEEDS

We plan to continue to spend substantial funds to expand our sales and marketing efforts and our research and development activities related to our therapeutic consumer products. Our future liquidity and capital requirements will depend upon numerous factors, including the costs and timing of sales and marketing, manufacturing and research and development activities, the extent to which our therapeutic consumer products gain market acceptance and competitive developments. Any additional required financing may not be available on satisfactory terms, if at all. If we are unable to obtain financing, we may be required to reduce or eliminate some or all of our sales and marketing efforts or research and development activities.

WE HAVE LIMITED STAFFING AND WILL CONTINUE TO BE DEPENDENT UPON KEY EMPLOYEES

Our success is dependent upon the efforts and abilities of our key employees. If key individuals leave, we could be adversely affected if suitable replacement personnel are not quickly recruited. Our future success depends upon our ability to continue to attract and retain qualified scientific, marketing and technical personnel. There is intense competition for qualified personnel in all functional areas and competition will make it difficult to attract and retain the qualified personnel necessary for the development and growth of our

business.

THE PRICE OF OUR COMMON STOCK COULD BE HIGHLY VOLATILE DUE TO A NUMBER OF FACTORS

The trading price of our common stock may fluctuate widely as a result of a number of factors, including:

- * performance of our therapeutic consumer products in the market;
- * regulatory developments in both the United States and foreign countries;
- * market perception and customer acceptance of our therapeutic consumer products;
- * increased competition;
- * relationships with resellers of our products;
- * economic and other external factors; and
- * period-to-period fluctuations in financial results.

In addition, the price of our common stock has from time to time experienced significant price and volume fluctuations that may be unrelated to our operating performance.

WE MAY NOT CONTINUE TO MEET THE REQUIREMENTS FOR CONTINUED LISTING ON NASDAQ

The National Association of Securities Dealers, Inc. which administers Nasdaq, has adopted certain criteria for continued eligibility on Nasdaq. In order to continue to be included on Nasdaq, we must maintain \$4 million in net tangible assets, a public float of 750,000 shares and a \$5 million market value of our public float. In addition, continued inclusion requires two market-makers, at least 400 holders of our common stock and a minimum bid price of our common stock of \$1 per share. Our failure in the future to meet these maintenance criteria, as now in effect or as may be later amended, may result in the delisting of our common stock from Nasdaq. In such event, trading, if any, in our common stock may then continue to be conducted in the non-Nasdaq over-the-counter market in less orderly markets commonly referred to as the electronic bulletin board and the "pink sheets." As a result, an investor may find it more difficult to dispose of or to obtain accurate quotations as to the market value of our common stock. If Nasdaq were to begin delisting proceedings against us, it could reduce the level of liquidity currently available to our shareholders. If our common stock were delisted, the price of our common stock would, in all likelihood, decline.