

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1995.

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  
(State or other jurisdiction of incorporation or organization)

41-1301878  
(I.R.S. Employer Identification No.)

10701 Red Circle Drive, Minnetonka, Minnesota  
(Address of principal executive offices)

55343  
(Zip Code)

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

The number of shares outstanding of the registrant's common stock as of November 1, 1995 was 3,797,554 shares.

LECTEC CORPORATION

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LECTEC CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

<TABLE>  
<CAPTION>

	September 30, 1995 (Unaudited)	June 30, 1995
ASSETS		
<S>	<C>	<C>
Current Assets		
Cash and cash equivalents	\$419,428	\$839,942
Receivables		
Trade, less allowance for doubtful accounts of \$26,999 (unaudited) and \$18,000 at September 30, 1995 and June 30, 1995, respectively	2,250,337	2,027,985
Refundable income taxes	125,357	119,540
Other	305,874	268,247
	2,681,568	2,415,772
Inventories		
Raw materials	1,317,235	1,162,559
Work-in-process	324,500	218,351
Finished goods	727,078	716,344
Total inventories	2,368,813	2,097,254
Prepaid expenses and other	405,068	229,796
Deferred tax asset	254,000	254,000
Total current assets	6,128,877	5,836,764
Property, Plant and Equipment - at Cost		
Building and improvements	1,613,887	1,673,069
Equipment	6,161,282	5,447,479
Furniture and fixtures	429,761	422,265
	8,204,930	7,542,813
Less accumulated depreciation	2,997,655	2,813,760
	5,207,275	4,729,053
Construction in progress	75,683	583,023
Land	247,731	247,731
	5,530,689	5,559,807
Other Assets		
Patents and trademarks, less accumulated amortization of \$586,203 (unaudited) and \$554,286 at September 30, 1995 and June 30, 1995, respectively	373,467	386,470
Goodwill, less accumulated amortization of \$295,002 (unaudited) and \$245,835 at September 30, 1995 and June 30, 1995, respectively	294,998	344,165
Long-term investments	579,930	568,156
Other	20,386	23,784
	1,268,781	1,322,575
	\$12,928,347	\$12,719,146

</TABLE>

See accompanying notes to the consolidated financial statements

LECTEC CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

<TABLE>  
<CAPTION>

	September 30, 1995 (Unaudited)	June 30, 1995
LIABILITIES AND SHAREHOLDERS' EQUITY		
<S>	<C>	<C>
Current Liabilities		
Notes payable	\$83,595	\$0
Accounts payable	1,024,904	771,471
Accrued expenses		

Payroll related	288,368	375,282
Distributor bonuses	70,736	71,384
Product returns	18,792	77,831
Other	109,908	50,000
<b>Total current liabilities</b>	<b>1,596,303</b>	<b>1,345,968</b>
Deferred Income Taxes	167,000	167,000
Shareholders' Equity		
Common stock, \$.01 par value: 15,000,000 shares authorized; issued and outstanding: 3,795,200 shares (unaudited) at September 30, 1995 and 3,786,500 shares at June 30, 1995	37,952	37,865
Additional paid-in capital	10,056,320	10,013,949
Unrealized losses on securities available-for-sale	(39,042)	(50,816)
Retained earnings	1,109,814	1,205,180
	11,165,044	11,206,178
	<b>\$12,928,347</b>	<b>\$12,719,146</b>

</TABLE>

See accompanying notes to the consolidated financial statements

LECTEC CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

<TABLE>  
<CAPTION>

	Three months ended September 30,	
	1995	1994
Revenues	(Unaudited)	(Unaudited)
<S>	<C>	<C>
Product sales	\$3,462,451	\$2,904,523
Total revenues	3,462,451	2,904,523
Cost of goods sold	2,123,247	1,557,214
Gross profit	1,339,204	1,347,309
Operating expenses		
Selling, general and administrative	941,490	789,290
Research and development	511,033	477,220
	1,452,523	1,266,510
Operating profit (loss)	(113,319)	80,799
Other income (expense)		
Interest income	9,823	19,624
Dividend income	9,131	9,231
Interest expense	0	0
Other	0	(5,659)
	18,954	23,196
Earnings (loss) before income tax expense	(94,365)	103,995
Income tax expense	1,001	25,059
Net earnings (loss)	(\$95,366)	\$78,936
Net earnings (loss) per common and common equivalent share	(\$0.03)	\$0.02
Weighted average number of common and common equivalent shares outstanding during the period	3,788,308	3,760,340

</TABLE>

See accompanying notes to the consolidated financial statements

LECTEC CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>  
<CAPTION>

	Three months Ended September 30, 1995 (Unaudited) <C>	Three months Ended September 30, 1994 (Unaudited) <C>
Cash flows from operating activities:		
<S> Net earnings (loss)	(\$95,366)	\$78,936
Adjustments to reconcile net earnings (loss) to net cash used in operating activities:		
Depreciation and amortization	264,979	174,436
Changes in operating assets and liabilities:		
Trade and other receivables	(265,796)	(296,991)
Inventories	(271,559)	(705,026)
Prepaid expenses and other	(171,874)	(125,756)
Accounts payable	253,433	46,689
Income taxes payable	0	25,059
Accrued expenses	(86,693)	56,963
Net cash used in operating activities	(372,876)	(745,690)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(154,777)	(253,583)
Investment in patents and trademarks	(18,914)	(47,307)
Purchase of marketable securities and other investments	0	(250,341)
Sale of marketable securities and other investments	0	863,354
Net cash (used in) provided by investing activities	(173,691)	312,123
Cash flows from financing activities:		
Issuance of common stock	42,458	22,263
Proceeds from notes payable	83,595	0
Net cash provided by financing activities	126,053	22,263
Net decrease in cash and cash equivalents	(420,514)	(411,304)
Cash and cash equivalents at beginning of period	839,942	785,770
Cash and cash equivalents at end of period	\$419,428	\$374,466

</TABLE>

See accompanying notes to the consolidated financial statements

LECTEC CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CASH FLOWS

Disclosures in Financial Statements

Supplemental Disclosures of Cash Flow Information

<TABLE>  
<CAPTION>

	Three months Ended September 30, 1995 (Unaudited) <C>	Three months Ended September 30, 1994 (Unaudited) <C>
Cash paid during the period for:		
<S> Interest expense	\$0	\$0
Income taxes	8,000	0

</TABLE>

See accompanying notes to the consolidated financial statements

LECTEC CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 1995

(1) General

The accompanying consolidated financial statements include the accounts of LecTec Corporation (the "Company"), LecTec International Corporation, a wholly-owned subsidiary, and Natus Corporation, a fifty-one percent owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation. The interim financial statements are unaudited and in the opinion of management, reflect all adjustments (which consist only of adjustments of a normal recurring nature) necessary for a fair presentation of results for the periods presented. Results for interim periods are not necessarily indicative of results for the year.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Product sales for the first quarter of fiscal 1996 were \$3,462,451 as compared with \$2,904,523 for the first quarter of fiscal 1995. The 19.2% increase in product sales was primarily the result of volume increases in medical tape products. Medical tape sales increased by 73.9% from the first quarter of fiscal 1995 primarily due to sales of a new product offering and sales to a major new retail customer. Conductive product sales decreased by 2.4% from the first quarter of fiscal 1995 to the first quarter of fiscal 1996 primarily due to delayed orders for diagnostic electrode products. Therapeutic product sales increased by 30.9% from the first quarter of fiscal 1995 to the first quarter of fiscal 1996 primarily due to increased analgesic pain patch sales by the Natus subsidiary.

Gross profit for the first quarter of fiscal 1996 was \$1,339,204 as compared with \$1,347,309 compared to the first quarter of fiscal 1995. Gross profit as a percent of total revenues for the first quarter of fiscal 1996 was 38.7% as compared to 46.4% for the first quarter of fiscal 1995. The decrease in gross profit percent for the quarter was primarily a reflection of a shift in the sales mix to the lower margin medical tape products and increased raw material costs for all products.

Selling, general and administrative expenses for the first quarters of fiscal 1996 and 1995, as a percentage of total revenues, were 27.2%. Selling, general and administrative expenses were \$941,490 and \$789,290 during the first quarter of fiscal 1996 and fiscal 1995, respectively. Increased selling, general and administrative expenses associated with restructuring the direct selling/network marketing organization of the Natus subsidiary were primarily responsible for this dollar amount increase.

Research and development expenses for the first quarter, as a percentage of total revenues, were 14.8% and 16.4% for fiscal 1996 and 1995, respectively. Research and development expenses for the first quarter of fiscal 1996 increased to \$511,033 from \$477,220 in fiscal 1995. The increase in expense is primarily attributable to the research and development costs associated with the non-nicotine smoking cessation product.

Other income (expense) decreased in the first quarter of fiscal 1996 to \$18,954 from \$23,196 in the first quarter of fiscal 1995. The decline resulted primarily from a reduction of interest and dividend income due to the liquidation of short-term investments to finance the acquisition of a new medical tape production line and a new therapeutic production line plus the increases in receivables and inventory necessary to support the growing business.

The Company had a loss before income tax expense of \$94,365 in the first quarter of fiscal 1996 compared to earnings before income tax expense of \$103,995 in the first quarter of fiscal 1995. The decrease in earnings before income taxes for the quarter was the result of an increase in the sales mix of lower margin medical tape products, increased raw material costs for products sold, expenses associated with restructuring the direct selling/network marketing organization of the Natus subsidiary and increased research and development expense. These factors offset the beneficial aspects of the increased overall sales.

Liquidity and Capital Resources

The Company has used internally generated cash to support growth and capital spending. The Company has a \$1,000,000 line of credit available to meet current operating requirements. The Company estimates that capital expenditures will approach \$3,300,000 for equipment and capital improvements during fiscal 1996 with expenditures anticipated to be financed by operations. The Company continues to have a strong Balance Sheet with no long-term debt and a current ratio at the end of the first quarter of fiscal 1996 of 3.84 as compared to 4.34

at the end of fiscal 1995. Working capital, at the end of the first quarter of fiscal 1996, increased to \$4,532,574 from \$4,490,796 at the end of fiscal 1995.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities

There have been no changes in the rights of security holders.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

The registrant is not aware of any other information of material importance to be included in this report.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits - None.

(b) Reports on Form 8-K

None

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 November 13, 1995

/s/ Erwin W. Templin II  
Erwin W. Templin II, EVP & CFO

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