Table of Contents

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

FORM 10-Q

(Mark One)

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

or

☐ **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.)
1407 South Kings Highway, Texarkana, TX	75501
(Address of principal executive offices)	(Zip Code)

(903)-832-0993
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ☐ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☑
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☑

As of November 16, 2009 the registrant had 4,290,026 shares of common stock outstanding.

LECTEC CORPORATION

REPORT ON FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009

Table of Contents

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," "wants," "expects," "anticipates," "intends," "will," "may," "should," or similar expressions. Such forward-looking statements are subject to risks and uncertainties which could cause results or developments to differ materially from those indicated in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the Company's dependence on royalty payments from Novartis Consumer Health, Inc., which is selling an adult vapor patch licensed by the Company, the Company's dependence on key personnel and Board of Director members, the success or failure of any attempt by the Company to protect or enforce its patents and territories of coverage, the outcome of pending patent infringement litigation against Chattem, Inc., Johnson & Johnson Consumer Company, Inc., a subsidiary of Johnson & Johnson, and Prince of Peace Enterprises, Inc., the issuance of new accounting pronouncements, information disseminated on internet message boards from posters expressing opinions that may or may not be factual, the availability of opportunities for licensing agreements related to patents that the Company holds, limitations on market expansion opportunities, the inclusion of a "going-concern" qualification in the Company's Form 10-K for the year ended December 31, 2008 from the Company's independent registered public accounting firm, and other risks and uncertainties as described in "Risk Factors" included in Item 1A as filed in the Company's Form 10-K for the year ended December 31, 2008.

PART 1 — FINANCIAL INFORMATION

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

LECTEC CORPORATION
CONDENSED BALANCE SHEETS

	September 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 227,482	$ 332,848
Infringement and royalty receivable	123,937	32,586
Prepaid expenses and other	65,965	88,823
Total current assets	417,384	454,257
FIXED ASSETS:		
Office equipment	6,633	6,633
Accumulated depreciation	(2,360)	(701)
	4,273	5,932
OTHER ASSETS:		
Patent costs	34,311	43,775
Prepaid insurance — director and officer	—	20,279
	34,311	64,054
TOTAL ASSETS	$ 455,968	$ 524,243
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 47,000	$ 26,155
Accrued expenses	92,225	54,901
Discontinued operations	130,000	130,000
Total current liabilities	269,225	211,056
SHAREHOLDERS' EQUITY:		
Common stock, $.01 par value; 15,000,000 shares authorized; 4,290,026 shares issued and outstanding at September 30, 2009 and December 31, 2008	42,900	42,900
Additional contributed capital	12,652,219	12,652,219
Accumulated deficit	(12,508,376)	(12,381,932)
	186,743	313,187
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 455,968	$ 524,243

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

LECTEC CORPORATION
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
REVENUE:				
Royalty and licensing fees	$ 24,215	$ 14,022	$ 76,633	$ 40,125
Infringement income	—	—	600,000	—
TOTAL REVENUE	24,215	14,022	676,633	40,125
OPERATING EXPENSES	155,221	599,869	803,809	974,197
Loss from operations	(131,006)	(585,847)	(127,176)	(934,072)
INTEREST INCOME	32	3,008	732	14,155
NET LOSS	$ (130,974)	$ (582,839)	$ (126,444)	$ (919,917)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic and diluted	4,290,026	4,290,026	4,290,026	4,269,227
LOSS PER COMMON SHARE:				
Basic and diluted	$ (0.03)	$ (0.14)	$ (0.03)	$ (0.22)

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

LECTEC CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30, 2009	2008
Cash flows from operating activities:		
Net loss	$ (126,444)	$ (919,917)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	1,659	—
Compensation expense related to issuance of stock options	—	455,080
Amortization of patent costs	16,189	16,591
Changes in operating assets and liabilities:		
Infringement and royalty receivable	(91,351)	86,409
Prepaid expenses and other	43,137	(37,745)
Accounts payable	20,845	11,540
Accrued expenses	37,324	(4,863)
Net cash used in operating activities	(98,641)	(392,905)
Cash flows from investing activities:		
Purchase of office equipment	—	(6,633)
Investment in patents	(6,725)	(23,280)
Net cash used in investing activities	(6,725)	(29,913)
Net decrease in cash and cash equivalents	(105,366)	(422,818)
Cash and cash equivalents — beginning of period	332,848	832,925
Cash and cash equivalents — end of period	$ 227,482	$ 410,107

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

LECTEC CORPORATION
Notes to Condensed Financial Statements
September 30, 2009 and 2008

(Unaudited)

(1) Basis of Presentation

The accompanying condensed financial statements include the accounts of LecTec Corporation (the "Company") as of September 30, 2009 and December 31, 2008 and for the three and nine month periods ended September 30, 2009 and 2008, respectively. The Company's condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The interim condensed financial statements are unaudited and in the opinion of management, reflect all adjustments necessary for a fair presentation of results for the periods presented. Results for interim periods are not necessarily indicative of results for the full year.

(2) Business/Premises Summary and Critical Accounting Policies

Business Summary

The Company is an intellectual property licensing and holding company. The Company earns royalties and licensing fees from licensing agreements pertaining to the Company's patents. The Company has one licensing agreement ("Novartis Agreement" or "Agreement") with Novartis Consumer Health, Inc. ("Novartis"), which pays royalties to the Company from time to time, within the terms of the Agreement, based upon a percentage of Novartis' net sales of licensed products. Previously, the Company was a contract manufacturer of hydrogel topical patches that were sold to major pharmaceutical customers until the Company ceased its manufacturing operations in December 2004. The Company holds multiple domestic and international patents based on its hydrogel technology. A hydrogel is a gel-like material that has an affinity for water and similar compounds. These hydrogels are ideal for delivering medication onto the skin.

Corporate Office and Premises Summary

The Company's principal executive office is located in Texarkana, Texas where it leases approximately 1,200 square feet of warehouse and office space. The lease began in August 2008 and expires on February 1, 2010. The Company intends to renew this lease before it expires.

The Company currently has three leased facilities as of September 30, 2009.

In January 2009, the Company entered into a lease amendment (the "Lease Amendment") amending its lease dated May 23, 2003, between the Company and SMD Lincoln Investments (the "Minnesota Lease"), regarding the Company's previous headquarters located at 5610 Lincoln Drive, Edina, Minnesota (the "Leased Premises"). The Lease Amendment will continue to renew for successive one-month periods until the Minnesota Lease is terminated by the landlord upon 30 days' written notice to the Company or by the Company upon 90 days' written notice to the landlord. The Company uses the space for liquidating saleable assets and managing an orderly wind down of operations at this facility. The Company maintains approximately 3,300 square feet of space at this facility.

In July 2008, the Company moved its corporate headquarter facilities from Edina, Minnesota to Texarkana, Texas. In connection with this relocation, the Company entered into a Lease Agreement with Lockaway Storage, Inc. (the "Lessor") on July 23, 2008 (the "Texas Lease"), pursuant to which the Company agreed to lease approximately 1,200 square feet of space located at 1407 South Kings Highway, Texarkana, Texas 75501, for a term of 6 months, beginning on August 1, 2008 and ending on February 1, 2009. The monthly lease rate was $650 per month during the term of the Texas Lease, and the Company must also pay its pro rata share of the costs and expenses incurred by the Lessor to operate the common areas of the office and warehouse complex. In February 2009, the Company renewed its Texas Lease until February 1, 2010 at a monthly lease rate of $700 per month. The Texas Lease contains customary representations, warranties and covenants on the part of the Company and the landlord.

In July 2008, the Company opened an office in India, which is located at Level 2, Connaught Place, Bund Garden Road, Pune, India 411001, to explore research, development and manufacturing opportunities for its advanced skin interface technologies and products. The Company chose India because the Company considers it to be one of the most robust,

globally competitive, and cost-efficient locations for the development and manufacturing of pharmaceutical and medical products. The Company also wants to have better access to the pool of well-educated scientific and engineering talent available in India. This lease expired on July 31, 2009. The Company gave written notification of its intent to renew this lease until July 31, 2010 and subsequently made a payment of $1,456 in August 2009 to fulfill the Company's rental obligation for the renewal period.

Critical Accounting Policies

The Company's most critical accounting policies include:

Revenue Recognition. Royalty and licensing fees are recognized when earned under the terms of the Novartis Agreement, based upon sales information of licensed products sold by Novartis, and when collection is reasonably assured. Infringement revenues are recognized when agreements are reached and signed and collection is reasonably assured.

Patent Costs. The carrying value of patent costs is reviewed periodically or when factors indicating impairment are present. Any impairment loss is measured as the amount by which the carrying value of the assets exceeds the fair value of the assets. The Company believes no such impairment currently exists.

Royalty Receivable. The Company grants credit to its only customer, Novartis, in the normal course of business and under the terms contained in the Agreement. Novartis pays royalty income to the Company pursuant to the terms of the Agreement. At September 30, 2009, the Company had an outstanding royalty receivable with Novartis of $23,937 which was subsequently paid on October 30, 2009. The Company records royalty income based on information provided by Novartis. Management believes, based upon past collection experience, that amounts due from Novartis outstanding from time to time are fully collectible.

Infringement Receivable. In May 2009, the Company entered into a settlement agreement and mutual release with the Mentholatum Company (see Note 9 of this Form 10-Q for details of the settlement agreement). At September 30, 2009 the Company had an outstanding receivable of $100,000 with the Mentholatum Company which was subsequently received on October 20, 2009. As of the date of the filing of this Form 10-Q, the Company has received all amounts due from the Mentholatum Company pursuant to the terms of the settlement agreement and mutual release.

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

Share-Based Compensation. The Company accounts for share-based compensation in accordance with Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*, which requires that compensation cost relating to share-based payment transactions (including the cost of all employee stock options) be recognized in the financial statements. That cost is measured based on the estimated fair value of the equity or liability instruments issued. The Company did not record any share-based compensation during the three and nine month periods ended September 30, 2009. During the three and nine month periods ended September 30, 2008, the Company recorded compensation expense of $455,080.

On September 26, 2008, the Compensation Committee of the Board of Directors of the Company granted stock options to each of the three members of the Board of Directors of the Company, as well as to its sole employee. The terms of the options granted to the four individuals were identical except that the options granted to Mr. William Johnson, the Company's only employee, qualified as incentive stock options under the Internal Revenue Code of 1986, as amended, while each of the three Directors of the Company was granted non-qualified stock options. Mr. William Johnson, Mr. C. Andrew Rollwagen and Dr. Daniel Sigg each received an option to purchase 16,000 shares of the Company's common stock at $4.00 per share and Mr. Judd Berlin received an option to purchase 66,000 shares of the Company's common stock at $4.00 per share. All of the options are fully vested and exercisable as of the date of grant and will expire on September 26, 2018. All of the options were granted under plans previously approved by the Company's shareholders and the exercise price for the options were issued at a price equal to the fair market value of the Company's common stock on the date of grant. All of the options provide that termination of service as a Director or employee of the Company for any reason other than for cause will not affect the terms of the option or cause the option to terminate. As a result of this transaction, the Company recorded share-based compensation expense of $455,080 or $0.11 per share for the three and nine month periods ended September 30,

2008. The fair value of the options granted were determined utilizing the Black-Scholes-Merton option pricing model. All of the Company's options were fully vested, and there were no modifications to existing grants, during the three and nine month periods ended September 30, 2009 and 2008.

Off-Balance Sheet Arrangements The Company does not have any "off-balance sheet arrangements" (as such term is defined in Item 303 of Regulation S-K) that are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, operating results, liquidity, capital expenditures or capital resources.

Recent Accounting Pronouncements:

In February 2008, the Financial Accounting Standard Board ("FASB") issued FASB Staff Position ("FSP") FAS 157-2, *Effective Date of FASB Statement No. 157,* ("FSP FAS 157-2"), which delays the effective date of SFAS No. 157 for all nonrecurring fair value measurements of non-financial assets and liabilities until fiscal years beginning after November 15, 2008. The adoption of FSP FAS 157-2 did not to have a material impact on the Company's financial position or results of operations.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* ("FSP FAS 142-3"). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). The intent of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141R (revised 2007), *Business Combinations,* and other generally accepted accounting principals. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The adoption of FSP FAS 142-3 did not have a material impact on the Company's financial position or results of operations.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* ("FSP FAS 107-1"). FSP FAS 107-1 essentially expands the disclosure about fair value of financial instruments that were previously required only annually to also be required for interim period reporting. In addition, FSP FAS 107-1 requires certain additional disclosures regarding the methods and significant assumptions used to estimate the fair value of financial instruments. FSP FAS 107-1 is effective for interim and annual periods ending after June 15, 2009. The adoption of FSP FAS 107-1 did not have a material impact on the Company's financial position or results of operations.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* ("SFAS 165"). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires disclosure of the date through which an entity has evaluated subsequent events. The Company adopted SFAS 165 in the second quarter of 2009 and the adoption of SFAS 165 did not impact the Company's financial statements. The Company has evaluated all events or transactions that occurred after September 30, 2009 up through November 16, 2009, the date the Company issued these financial statements. The Company has disclosed a subsequent event that occurred in November 2009 in Note 12 of Notes to Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.

In June 2009, the FASB issued SFAS No. 168, *The "FASB Accounting Standards Codification"* and *The Hierarchy of Generally Accepted Accounting Principles*. This standard replaces SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and establishes only two levels of U.S. generally accepted accounting principles ("GAAP"), authoritative and non-authoritative. The FASB Accounting Standards Codification (the "Codification") will become the source of authoritative, nongovernmental GAAP, except for rules and interpretive releases of the Securities and Exchange Commission ("SEC"), which are sources of authoritative GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature not included in the Codification will become non-authoritative. This standard is effective for financial statements for interim or annual reporting periods ending after September 15, 2009. As the Codification was not intended to change or alter existing GAAP, it will not have any impact on the Company's financial statements.

(3) Loss Per Common Share

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

options to purchase 264,000 shares of common stock with a weighted average exercise price of $3.94 per share were outstanding during the three and nine months ended September 30, 2009. Common stock options and warrants to purchase 269,200 shares of common stock with a weighted average exercise price of $3.93 were outstanding during the three and nine months ended September 30, 2008. Because the Company had a loss from operations during the three and nine months ended September 30, 2009 and 2008, those shares were excluded from the loss per share computations because they were antidilutive.

(4) Income Taxes

The provision for income taxes for the three and nine months ended September 30, 2009 and 2008, was offset by a valuation allowance for deferred taxes. No federal or state income tax benefit was provided for the three and nine months ended September 30, 2009 and 2008, as the realization of such benefit is not reasonably assured.

(5) Novartis Supply and License Agreement

In July 2004, the Company entered into a supply and licensing agreement with Novartis, effective January 1, 2004. By December 31, 2004, the supply portion of the Agreement was completed and the Company no longer manufactured any product. Under the Agreement, the Company granted Novartis an exclusive license (the "License") to all of the intellectual property of the Company to the extent that it is used or is useful in the production of the vapor patches that Novartis is selling under the Agreement. The License will continue in effect for the duration of the patents' life permitted under applicable law. Upon the expiration of the patents included in the licensed intellectual property, Novartis will have a non-revocable, perpetual, fully paid-up license to the intellectual property used or useful in the production of vapor patches for the pediatric and the adult cough/cold market. Novartis is required by the Agreement to pay royalties to the Company at an agreed upon percentage based on net sales of vapor patches by Novartis for each year the License is in effect.

In June 2006, Novartis issued a nationwide recall of all of its Triaminic® vapor patch products. In a press release issued by Novartis pertaining to the recall, Novartis explained that the recall was "due to the serious adverse health effects that could result if the product is ingested by a child removing the patch and chewing on it." At the same time that Novartis announced this voluntary recall, the U.S. Food and Drug Administration ("FDA") issued a release warning consumers "not to use the Triaminic Vapor Patch due to reports of serious adverse events associated with accidental ingestion by children." According to news reports, the recall resulted from an adverse event experienced by a child who suffered a seizure after chewing on a Triaminic Vapor Patch. Novartis confirmed to the Company that the patch involved in this incident was not manufactured by the Company. As a result of this recall, the Company was proactive in assisting Novartis to resolve the FDA issues surrounding the product recall in order to restore the Company's royalty income stream. The Company met with Novartis representatives to discuss how to prevent an incident where a child or pet chews or ingests a patch and also discussed potential opportunities related to other patents the Company holds, including pending patent applications that the Company has applied for.

In January 2007, the Company engaged an independent consulting firm to audit royalties due to the Company pursuant to the Agreement. In January 2008, the Company was paid $21,946 by Novartis as settlement for underpaid royalty income and audit costs.

In April 2007, the Company was informed that the U.S. Patent and Trademark Office (the "USPTO") had completed a re-examination of a patent pertinent to the Agreement and the Company was issued a re-examination certificate. The patent is entitled "Non-Occlusive Adhesive Patch for Applying Medication to the Skin" and covers the design for adhesive patches, which contain a reservoir of medication to be delivered through the inhalation of vapors.

Beginning in July 2007, Novartis began shipping the adult vapor patch product in the United States, Canada, and Mexico for the cough, cold, and flu seasons. Novartis has not announced whether it will re-introduce a vapor patch for the pediatric market.

Currently, the product is marketed under the Theraflu brand name by Novartis as VaporPatch. Novartis advertises and markets the VaporPatch via TV commercials, information on Novartis' website, and various stores continue to shelve and sell the VaporPatch product. The Company continues to receive royalty income under the terms of the Novartis Agreement.

During the three and nine months ended September 30, 2009, the Company recorded revenue of $24,215 and $76,633, respectively, for royalties received under the Agreement. During the three and nine months ended September 30, 2008, the Company recorded revenue of $14,022 and $40,125, respectively, for royalties received under the Agreement.

(6) Discontinued Operations

The Company ceased manufacturing operations of topical patches and sold all of its manufacturing assets related to the production of patches to its only remaining customer, Novartis, as of December 31, 2004. The liability for discontinued operations at September 30, 2009 and December 31, 2008 consisted of a reserve for sales returns and credits of $130,000 related to sales prior to the discontinuance of operations.

(7) Equity Transactions

Warrants

In connection with the sale of the Company's corporate facility during 2003, the Company issued warrants to an outside party to purchase 200,000 shares of the Company's common stock. The warrants were exercisable, and could be exercised on a cashless basis, and entitled the holder to purchase the Company's common stock at $0.90 per share until February 25, 2008.

On February 21, 2008, the warrant holder exercised, on a cashless basis, the warrant. Accordingly, the warrant holder forfeited a number of shares underlying the warrant with a "fair market value" (calculated pursuant to the warrant agreement) and received 113,978 shares of the Company's common stock upon exercise of the warrant. As a result of the cashless exercise, the Company did not receive any cash proceeds from the exercise. As of the filing date of this Form 10-Q, the Company has no outstanding warrants.

(8) Patents and Trademarks

The Company has several U.S. and international patents related to its patch technology. Eighteen issued U.S. patents and forty-two issued international patents are currently assigned to the Company. The Company has four U.S. patent pending applications including provisional applications (see below) and two foreign applications. The patents most pertinent to the Company's major products have a remaining legal duration ranging from approximately five to fourteen years. The Company also holds three registered U.S. trademarks.

In 2008 and 2007, the Company filed for two provisional patents, which include (i) adding an aversive agent to our licensed patch or other patches to prevent ingestion by children or pets and (ii) a hand sanitizing patch that will kill targeted infectious organisms. The hand sanitizing patch is intended to be dry, thereby rendering the patch harmless in the event that it is licked, chewed or exposed to the eye. The Company can give no assurance to the intended purpose of the claims related to these patents until these patents are issued

On September 11, 2009 the international patent for the hand sanitizing patch was published. A published patent does not mean the patent has been issued. Based upon information from the Company's patent attorneys, it can take up to three years for a patent to be issued once it has been published, however, the application does give the Company a priority date. This applies to our U.S. and our international applications for the hand sanitizer and aversive agent patches.

Issued patents can later be held invalid by the patent office issuing the patent or by a court of law. The Company cannot be certain that its patents will not be challenged, invalidated, circumvented, or that the rights granted under the Company's patents will provide a competitive advantage.

The Company uses both patents and trade secrets to protect its proprietary property and information. To the extent the Company relies on confidential information to maintain its competitive position, there can be no assurance that other parties will not independently develop the same or similar information.

On July 25, 2008, the Company filed a Complaint for patent infringement against five companies, alleging that the defendants have infringed upon two of the Company's patents relating to its medicated patch technology. The Company has disclosed details of the pending lawsuit in previous SEC filings. In October 2008, all five of the defendants in these lawsuits filed answers to the Company's complaint. The Company appeared in court on December 3, 2008 for a scheduling conference.

In February 2009, the Company's legal counsel filed with the Court a motion to preliminarily enjoin the defendants from infringing the Company's patents pending a jury trial scheduled for January 11, 2011. A hearing on this preliminary injunction motion was scheduled for November 12, 2009, in Texarkana, Texas. The Company subsequently cancelled this hearing due to legal considerations after it agreed to settle with a second defendant in the action. The Company will continue to pursue settlement options with respect to the other defendants. The Company can not give any assurance as to the outcome of future negotiations. See PART II, ITEM 1 of this Form 10-Q for additional information.

(9) Mentholatum Settlement

On May 29, 2009, the Company entered into a Settlement Agreement and Mutual Release (the "Mentholatum Settlement Agreement") with the Mentholatum Company ("Mentholatum") to settle the Company's claims against Mentholatum that Mentholatum infringed two of the Company's patents ("Patents–In–Suit") related to its medicated patch technology (the "Litigation"). Pursuant to the Mentholatum Settlement Agreement, Mentholatum will pay the Company an aggregate of $600,000 in $100,000 monthly installments from May through October 2009. In addition, under the Mentholatum Settlement Agreement (a) the Company agreed to dismiss the Litigation against Mentholatum with prejudice, (b) the parties agreed to mutual general releases of all claims other than their prospective obligations under the Mentholatum Settlement Agreement and claims arising after the date of the Mentholatum Settlement Agreement, (c) the Company agreed not to sue Mentholatum or Rohto Pharmaceutical Co., Ltd., the parent company of Mentholatum, for any infringement of the Patents–In–Suit, any patent that claims priority, directly or indirectly, from the Patents–In–Suit, or any foreign counterparts of the Patents–In–Suit (collectively, the "Patents"), (d) the Company agreed not to transfer the Patents unless the transferee agrees to be bound by the covenant not to sue described above in clause (c), and (e). Mentholatum and Rohto agreed not to challenge the validity or enforceability of the Patents.

As of September 30, 2009, Mentholatum had paid the Company $500,000 pursuant to the terms of the Mentholatum Settlement Agreement, and as of October 20, 2009, the Company had been paid the entire $600,000 pursuant to the terms of the Mentholatum Settlement Agreement. The proceeds received from this settlement have been reduced by the amounts due to the Raider firm. The Companies contingent fee, out of pocket expenses, and other costs incurred related to depositions of parties in the infringement lawsuits and other related costs. After these expenses the company received net cash proceeds of approximately $300,000 from the Mentholatum settlement.

(10) Officer Reimbursement

The accounts payable balance of $47,000 at September 30, 2009 includes $30,000 that the Board of Directors has determined to pay to Judd Berlin, the Company's Chief Executive Officer. The Board of Directors determined to make the payment to Mr. Berlin to compensate him for the loss of his foreign earned income exclusion of $87,600. The estimated tax implication to Mr. Berlin is approximately $30,000. The forfeiture of his deduction results from Mr. Berlin spending more than 30 days in the United States to attend meetings and depositions on behalf of the Company. The Board of Directors has determined that the $30,000 will be paid to Mr. Berlin out of proceeds received from future infringement settlements, if any.

(11) Going Concern

The Company has incurred operating losses, accumulated deficits and negative cash flows from operations during the last several years. As of September 30, 2009, the Company had an accumulated shareholders' deficit of $12,508,376. At September 30, 2009, the Company had substantial doubt that its existing cash and cash equivalents would be sufficient to fund operations through 2010 and beyond based upon its current cash on hand, its anticipated operating expenses, costs the Company is likely to incur related to its pending patent infringement litigation, receipt of sufficient royalty income, and uncertainties about the potential settlements the Company may receive as a result of its ongoing litigation efforts. The going concern issue will be mitigated by the Company's settlement on November 6, 2009 with Endo Pharmaceuticals Inc. which

will provide the Company with additional cash in December 2009. See Note 12 of Notes to Condensed Financial Statements in Part I, Item 1 for more information.

The Company is exploring means to raise additional capital including future patent infringement settlements, to allow the Company to sustain normal operations in 2009 and beyond and proceed with R&D efforts in India and China relating to the Company's hand sanitizer patch, its patch with aversive agent, other patents the Company holds, and related testing and research efforts. In addition to these efforts to raise additional capital, the Company's strategy includes pursuing additional licensing agreements with interested companies; negotiating additional patent infringement settlement agreements; potential partnering arrangements with Novartis or other companies; evaluating merger and acquisition possibilities; and exploring partnerships with domestic and foreign manufacturers to develop and commercialize the Company's proprietary patch technology.

The Company's financial statements do not include any adjustments related to recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

(12) Subsequent Event

On November 6, 2009, the Company and Endo Pharmaceuticals Inc. ("*Endo*"), executed a Term Sheet that set forth the terms of a settlement and license agreement pursuant to which the parties would settle the Company's claims against Endo that Endo infringed the *Patents–In–Suit* in the *Litigation*. On November 11, 2009, the Company entered into such Settlement and License Agreement (the "*Endo Settlement Agreement*") with Endo and issued a press release announcing its entry into the Endo Settlement Agreement. On November 12, 2009 the Company filed a Form 8-K with the Securities and Exchange Commission disclosing this event.

Pursuant to the Endo Settlement Agreement, Endo will pay the Company a one–time license fee of $23,000,000 and the Company will grant to Endo an exclusive license to the Patents–In–Suit for use in the field of prescription pain medicines and treatment. In addition, under the Endo Settlement Agreement: (a) the parties agreed to the dismissal of the Litigation with prejudice and without costs; (b) the Company agreed to release all claims against Endo that were asserted by or could have been asserted by the Company against Endo in the Litigation or that relate to, arise from or are in any manner connected to the Patents–In–Suit; (c) Endo agreed to release all claims against the Company that were asserted by or could have been asserted by Endo against the Company in the Litigation; (d) the Company agreed not to sue Endo for any infringement of any U.S. or foreign patents or patent applications owned or controlled by the Company as of November 11, 2009, any continuation, continuation–in–part or divisional of any such patent, any U.S. patent resulting from the reissue or reexamination of any of such patents and any U.S. or foreign patent or patent application claiming common priority with any of such patents; and (e) the Company agreed not to transfer either of the Patents–In–Suit or any other such patent unless the transferee agrees in writing to the terms and conditions of the Endo Settlement Agreement.

The Company anticipates receiving approximately $16 million in net cash proceeds from this settlement. The agreement also calls for payment on or before December 15, 2009. From these proceeds the Company intends to replenish the trust fund it has with the Rader Firm with $1 million dollars to fund ongoing patent litigation. If funds are not completely expended, then the remaining cash balance in the trust fund will revert to the Company. Additionally, the Company estimates that it will have to pay federal and state taxes of approximately $1 to $1.5 million dollars related to this transaction.

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

OVERVIEW

The Company's strategy is to evaluate and promote its current intellectual property portfolio for licensing purposes to domestic and foreign manufacturers to enable them to use the Company's proprietary patch technology to produce or sell topical patch products in the future. This effort will also enhance the Company's options with respect to future licensing opportunities, and may attract potential merger or acquisition candidates or the sale of the Company. The Company is taking steps to strengthen its patent portfolio for territories of use, including the United States, Europe, and other countries. The Company is also focused on strengthening its position with respect to the protection of its rights related to its current intellectual property portfolio. It is currently management's intent to fund operations with royalty income from licensing agreements or from other income derived from the protection of patent rights pertaining to the Company's intellectual property.

In February 2007, the Company engaged a consulting firm to conduct an extensive market research and intellectual property analysis of its patent portfolio and technology. The Company subsequently evaluated emerging markets as a strategic growth opportunity for the Company and determined that India has significant potential. The Company has opened an office in India and is specifically evaluating R&D opportunities, strategic partnerships and potential licensing opportunities.

In April 2007, the Company was granted a re-examination certificate that expanded the Company's prior claims related to a patent the Company holds. The Company continues to take steps to evaluate its current position in light of this event, including market research studies, product testing, and using other outside resources in conjunction with other efforts to gather and document information to aid in the protection of the Company's patent rights.

In June 2006, Novartis issued a nationwide recall of all of its vapor patch products sold under the Novartis Agreement. See Note 5 of Notes to Condensed Financial Statements in Part I, Item 1 for more information.

In 2007, Novartis launched an adult vapor patch product in the United States for the cough, cold and flu season. This was a significant development for the Company in its effort to restart its revenue stream. As a result of the launch of the adult vapor patch, the Company is, once again, receiving royalty income based upon sales of these vapor patch products under the terms of the Novartis Agreement.

In 2008, the Company retained a contingent fee legal firm to enforce the Company's rights related to potential patent infringement claims by the Company. As a result, the Company has sued five potential patent infringers. The Company has made a motion for a preliminary injunction in the U.S. District Court for the Eastern District of Texas against the defendants that would prevent the defendants from selling potentially infringing products until the Company's claims are resolved.

In May 2009, the Company executed a settlement agreement and mutual release with one of these defendants and subsequently settled with another defendant in November 2009. See Notes 9 and 12 of Notes to Condensed Financial Statements in Part I, Item 1 for more information. The Company was scheduled for a hearing in Texarkana, Texas on November 12, 2009 relating to the preliminary injunction motion it filed in the Litigation. The Company subsequently cancelled this hearing due to legal considerations after it agreed to settle with a second defendant in the action. The Company will continue to pursue settlement options with respect to the other defendants. The Company can not give any assurance as to the outcome of future negotiations.

The Company continues to explore opportunities with other companies that may have an interest in our technology and patent portfolio. The Company is also exploring opportunities surrounding R & D.

COMPARISON OF THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

Results of Operations

The Company recorded revenue of $24,215 and $676,633 for the three and nine month periods ended September 30, 2009, respectively. The Company recorded revenue of $14,022 and $40,125 for the three and nine month periods ended September 30, 2008, respectively. The increase in revenue for the nine month period ended September 30, 2009 over the comparable period in 2008 was primarily due to an increase in infringement revenue of $600,000. Royalty income also increased $10,193 and $36,508 for the three and nine month periods ended September 30, 2009, respectively, from the comparable periods in 2008. The increase in royalty income for the three and nine months periods ended September 30, 2009 over the comparable period in 2008, was due to stronger sales of licensed products in Mexico. The royalty income recorded during the three and nine month periods ended September 30, 2009 and 2008 was based on information provided by Novartis.

Operating expenses decreased $444,648, to $155,221 for the three months ended September 30, 2009, from operating expenses of $599,869 for the comparable period in 2008. The decrease in operating expenses resulted primarily from the Company recording compensation expense of $455,080 related to the issuance of stock options during the third quarter ended September 30, 2008. For the nine months ended September 30, 2009, operating expenses decreased $170,388 to $803,809, from $974,197 for the nine months ended September 30, 2008. The decrease in operating expenses is due primarily due to a reduction in compensation expense of $455,080 coupled with a reduction in general operating expenses which were partially offset by expenses incurred in connection with the Company's patent infringement lawsuit, including approximately $300,000 in litigation settlement fees, and consulting, legal, other out of pocket expenses.

The Company recorded a net loss of $(130,974), or $(0.03) per basic and diluted share for the three months ended September 30, 2009, compared to a net loss of $(582,839), or $(0.14) per basic and diluted share, for the same period in 2008. The improvement in the net loss of $451,865 for the three month period ended September 30, 2009 from the comparable period in 2008 is primarily due to the Company not recording any compensation expense for the three months ended September 30, 2009 compared to the Company recording compensation expense of $455,080 during the three months ended September 30, 2008. For the nine months ended September 30, 2009, the Company recorded a net loss of $(126,444), or $(0.03) per basic and diluted share, compared to a net loss of $(919,917), or $(0.22) per basic and diluted share, for the same period in the 2008. The improvement in the net loss of $793,473 for the nine month period ended September 30, 2009 compared to the net loss for the comparable period in 2008 is due to an increase in infringement income of $600,000, and an increase in royalty income of $36,508, coupled with reductions in general operating expenses including lack of compensation expense of $455,080, which was partially offset by increases in costs of approximately $300,000 associated with the Company's litigation efforts.

Income Taxes

The provision for income tax benefits for the three and nine month periods ended September 30, 2009 and 2008 was offset by a valuation allowance for deferred taxes. No federal or state income tax benefit was provided for the three and nine month periods ended September 30, 2009 and 2008, as the realization of such benefits is not reasonably assured.

Effect of Inflation

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

Liquidity and Capital Resources

Cash and cash equivalents decreased $105,366 for the nine month period ended September 30, 2009, to $227,482, from cash and cash equivalents of $332,848 at December 31, 2008. The decrease in cash and cash equivalents resulted primarily from the Company's ongoing expenses to maintain current operations of the Company.

The Company had no material commitments for capital expenditures at September 30, 2009 or 2008.

The Company had working capital of $148,159 and a current ratio of 1.55 at September 30, 2009 compared to working capital of $243,201 and a current ratio of 2.15 at December 31, 2008. The decline in working capital and the

current ratio at September 30, 2009, compared to December 31, 2008, was primarily due to the net loss of $(126,444) the Company incurred during the nine months ended September 30, 2009.

Shareholders' equity decreased $(126,444) to $186,743 at September 30, 2009 from $313,187 at December 31, 2008, due to the net loss generated by the Company during the nine month period ended September 30, 2009.

In June 2008, the Company entered into a contingent fee agreement with Rader, Fishman & Grauer PLLC ("Rader firm"), its legal counsel in the pending patent infringement litigation (See Part II, Item 1 of this Form 10-Q for additional details). Under the agreement, the Rader firm will receive a percentage of any recovery in the litigation or other proceeds resulting from a settlement of the litigation as its primary compensation for representing the Company in this matter. The Company is also obligated (i) to reimburse the Rader firm for its out-of-pocket expenses in connection with the litigation, and (ii) to engage and pay for expert services needed in the litigation, provided that the Company's obligation to advance such funds and pay such expert expenses will be suspended if the Company's cash levels fall below certain thresholds. Thereafter, if the Company's cash levels exceed such thresholds, or there is a recovery in or other proceeds from the litigation, then the Rader firm will be reimbursed for any expenses it has covered while such advances and payments were suspended. Pursuant to the Agreement the Company has with the Rader firm, a trust account was established for the purpose of funding out of pocket expenses and advances made by the Company for incurred expenses. The trust account earns nominal interest and the Company has recorded interest income of $511 for the nine months ended September 30, 2009. Through September 30, 2009, the Company has paid approximately $152,000 (net of interest income) in advances and out of pocket expenses from the trust fund to the Rader firm. The trust fund balance as of September 30, 2009 was $5,036. The Company has also paid additional costs outside of the trust fund of approximately $67,000 for expert services and deposition costs. The Company is also obligated to pay the Rader firm a percentage of any proceeds it receives from settlement of its pending lawsuits.

The Company is diligent about preserving its current cash flow with respect to its current litigation efforts and its ability to sustain normal operations going forward. The Company is exploring raising additional capital to allow the Company to sustain normal operations in addition to proceeding with research and development efforts in India and China relating to the Company's hand sanitizer patch, its patch with aversive agent, and other patents the Company holds, as well as related R & D and testing research. Without adequate cash or additional infringement settlement income, the royalty income received from Novartis, or other sources may not be sufficient to fund our efforts.

The Company earns interest on its available cash in addition to the trust arrangement the Company has with the Radar firm. Interest income earned during the three and nine month periods ended September 30, 2009 was $32 and $732, respectively. Interest income earned during the three and nine month periods ended September 30, 2008 was $3,008 and $14,155, respectively. The current average interest the Company earns on its available cash is less than 1%. The decrease in interest income for the three and nine month periods ended September 30, 2009 from the comparable periods in 2008, results from a decrease in the Company's cash available for investment and a general decline in interest rates because of the current economic conditions.

The Company's working capital requirements are dependent upon receipt of adequate levels of royalty and licensing income to fund its operations. The Company currently estimates that it will receive $80,000 to $100,000 per year in royalty income based upon historical royalty income and subsequent cash received from Novartis. Royalty income is uncertain because it is subject to factors that the Company cannot control.

The Company entered into a settlement agreement and mutual release with Mentholatum for $600,000, which was payable in $100,000 monthly installments from May through October 2009, which provided cash flow for the Company and a short term cash infusion that offset the Company's net cash usage of approximately $35,000 per month. The proceeds received from this settlement have been reduced by the amounts due to the Raider firm. The Companies contingent fee, out of pocket expenses, and other costs incurred related to depositions of parties in the infringement lawsuits and other related costs. After these expenses the company received net cash proceeds of approximately $300,000 from the Mentholatum settlement.

On November 6, 2009, the Company and Endo executed a Term Sheet that set forth the terms of a settlement and license agreement pursuant to which the parties would settle the Company's claims against Endo that Endo infringed two of the Company's patents related to the Company's medicated patch technology. On November 11, 2009, the Company entered into such Settlement and License Agreement with Endo. Under the terms of the Settlement Agreement, Endo will pay the Company a one–time license fee of $23,000,000 and the Company will grant to Endo an exclusive license to the Patents–In–Suit for use in the field of prescription pain medicines and treatment. The Company anticipates receiving approximately $16 million in net cash proceeds from this settlement. The agreement also calls for payment on or before December 15, 2009. From these proceeds the Company intends to replenish the trust fund it has with the Rader Firm with $1 million dollars to

fund ongoing patent litigation. If funds are not completely expended, then the remaining cash balance in the trust fund will revert to the Company. Additionally, the Company estimates that it will have to pay federal and state taxes of approximately $1 to $1.5 million dollars related to this transaction. See Note 12 of Notes to Condensed Financial Statements in Part I, Item 1 for more information.

There can be no assurance that the anticipated revenue stream or the anticipated expenses will be as planned, or that the Company will be successful in negotiating new licensing opportunities with Novartis or other companies, raising additional capital, prevailing in its patent infringement claims or otherwise settling such claims with the defendants, due to the uncertainties and risks described in "Risk Factors" in Item 1A. filed on Form 10-K for the period ending December 31, 2008.

GOING CONCERN

We have incurred operating losses, accumulated deficit and negative cash flows from operations during the last several years. As of September 30, 2009, the Company has an accumulated shareholders' deficit of $12,508,376. These factors, among others, raise substantial doubt about our ability to continue as a going concern. The going concern issue will be mitigated by the Company's settlement on November 6, 2009, with Endo Pharmaceuticals Inc. which will provide the Company with additional cash in December 2009. See Note 12 of Notes to Condensed Financial Statements in Part I, Item 1 for more information. Our financial statements included in this Form 10-Q do not include any adjustments related to recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should we be unable to continue as a going concern. There can be no assurance that the anticipated revenue stream or the anticipated expenses will be as planned, or that the Company will be successful in negotiating new licensing opportunities with Novartis or other companies, raising additional capital including settlement income from future patent infringement negotiations, due to the uncertainties and risks described in "Risk Factors" in Item 1A. filed on Form 10-K for the year ended December 31, 2008.

CRITICAL ACCOUNTING POLICIES

Management believes that the Company has not adopted any critical accounting policies which, if changed, would result in a material change in financial estimates, financial condition, results of operation or cash flows for the three months ended September 30, 2009 and 2008. The critical accounting policies appear in Note 2 of Notes to Condensed Financial Statements in this Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

Not Applicable.

ITEM 4T. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains "disclosure controls and procedures" as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act") that are designed to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, and Board of Directors, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable assurance of achieving the desired objectives, and we necessarily are required to apply our judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures.

Our management, including our principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2009 and concluded that our disclosure controls and procedures were effective.

Changes in Internal Controls Over Financial Reporting

During the quarter ended September 30, 2009, there were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) and 15d–15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1 — LEGAL PROCEEDINGS

On July 25, 2008, the Company filed a complaint for patent infringement (the "Complaint") against five companies, including Chattem, Inc. (Ticker: CHTT), Endo Pharmaceuticals, Inc. (Ticker: ENDP), Johnson & Johnson Consumer Company, Inc. (Ticker: JNJ), The Mentholatum Company, Inc (Division of Rohto Pharmaceuticals, Ticker RPHCF.PK), and Prince of Peace Enterprises, Inc. (Private Company) (collectively, the "Defendants") in the U.S. District Court for the Eastern District of Texas. The Complaint alleges, among other things, that the Defendants have infringed two of the Company's patents (the "Patents–In–Suit"), which relate to the Company's medicated patch technology. The Company is seeking to enjoin the Defendants from infringing the Patents–In–Suit and to recover monetary damages related to such infringement, as well as interest and litigation costs.

In October 2008, all five of the Defendants filed answers (the "Answers") in response to the Complaint denying the Company's claims therein, and asserting certain affirmative defenses and counterclaims against the Company, including assertions that the Patents–In–Suit are invalid and unenforceable, and claims for attorneys' fees and costs. On October 20, 2008, the Company filed its replies to the Answers, denying such counterclaims and affirmative defenses, including the claims that the Patents–In–Suit are invalid and unenforceable.

On December 3, 2008, the Company's counsel in the litigation, Rader, Fishman & Grauer PLLC (the "Counsel"), participated in a scheduling conference in this case. As a result of that conference, the Court scheduled a Markman hearing for May 6, 2010 and a final pretrial conference for January 3, 2011. Based on the schedule established by the Court, it is clear that pursuing the Company's claims in this litigation through trial will be a lengthy process.

In February 2009, Counsel filed with the Court a motion to preliminarily enjoin the five defendants from infringing the Patents pending the trial.

On May 29, 2009, the Company entered into a Settlement Agreement and Mutual Release (the "Mentholatum Settlement Agreement") with the Mentholatum Company ("Mentholatum") to settle the Company's claims against Mentholatum that Mentholatum infringed the Patents–In–Suit in the Litigation. Pursuant to the Mentholatum Settlement Agreement, Mentholatum paid the Company an aggregate of $600,000 in $100,000 monthly installments from May through October 2009. In addition, under the Mentholatum Settlement Agreement (a) the Company agreed to dismiss the Litigation against Mentholatum with prejudice, (b) the parties agreed to mutual general releases of all claims other than their prospective obligations under the Mentholatum Settlement Agreement and claims arising after the date of the Mentholatum Settlement Agreement, (c) the Company agreed not to sue Mentholatum or Rohto Pharmaceutical Co., Ltd., the parent company of Mentholatum, for any infringement of the Patents–In–Suit, any patent that claims priority, directly or indirectly, from the Patents–In–Suit, or any foreign counterparts of the Patents–In–Suit, (d) the Company agreed not to transfer any such patents unless the transferee agrees to be bound by the covenant not to sue described above in clause (c), and (e). Mentholatum and Rohto agreed not to challenge the validity or enforceability of such patents.

As of September 30, 2009, Mentholatum had paid the Company $500,000 pursuant to the terms of the Settlement Agreement, and as of October 20, 2009, the Company had been paid the entire $600,000 pursuant to the terms of the Mentholatum Settlement Agreement. The proceeds received from this settlement were reduced by the amounts due to the Rader firm per the Company's contingent fee arrangement, out of pocket expenses, and other costs incurred related to depositions of parties in the infringement lawsuits, travel expenses, and other related costs. The Company received approximately $300,000 in net cash proceeds from the Mentholatum settlement.

In July 2009, the presiding judge in the eastern district of Texas, granted the remaining defendants' a Joint Motion for an Extension of Time regarding the Company's Motion for Preliminary Injunction. The defendants' opposition briefs were filed by the end of August 2009. The Company's response to those briefs was filed by the end of September 2009. While some of the other scheduling order dates were modified, the Markman hearing and final pretrial trial dates remained unchanged The Company is being diligent in moving the infringement lawsuit forward but can give no assurance as to the outcome or settlement of the suit against the remaining defendants. The Company was scheduled for a hearing in Texarkana, Texas on November 12, 2009 relating to the preliminary injunction motion filed against the defendants in the Litigation. The Company subsequently cancelled this hearing

due to legal considerations after it settled with a second defendant in November 2009. The Company will continue to pursue settlement options with respect to the other defendants. The Company can not give any assurance as to the outcome of future negotiations.

On November 6, 2009, the Company and Endo Pharmaceuticals Inc. ("Endo"), executed a Term Sheet that set forth the terms of a settlement and license agreement pursuant to which the parties would settle the Company's claims against Endo that Endo infringed the Patents–In–Suit. On November 11, 2009, the Company entered into such Settlement and License Agreement (the "Endo Settlement Agreement") with Endo and issued a press release announcing its entry into the Endo Settlement Agreement. On November 12, 2009 the Company filed a Form 8-K with the Securities and Exchange Commission disclosing this event.

Pursuant to the Endo Settlement Agreement, Endo will pay the Company a one–time license fee of $23,000,000 and the Company will grant to Endo an exclusive license to the Patents–In–Suit for use in the field of prescription pain medicines and treatment. In addition, under the Endo Settlement Agreement: (a) the parties agreed to the dismissal of the Litigation with prejudice and without costs; (b) the Company agreed to release all claims against Endo that were asserted by or could have been asserted by the Company against Endo in the Litigation or that relate to, arise from or are in any manner connected to the Patents–In–Suit; (c) Endo agreed to release all claims against the Company that were asserted by or could have been asserted by Endo against the Company in the Litigation; (d) the Company agreed not to sue Endo for any infringement of any U.S. or foreign patents or patent applications owned or controlled by the Company as of November 11, 2009, any continuation, continuation–in–part or divisional of any such patent, any U.S. patent resulting from the reissue or reexamination of any such patents and any U.S. or foreign patent or patent application claiming common priority with any of such patents; and (e) the Company agreed not to transfer either of the Patents–In–Suit or any other such patent unless the transferee agrees in writing to the terms and conditions of the Endo Settlement Agreement.

The Company anticipates receiving approximately $16 million in net cash proceeds from this settlement. The agreement also calls for payment on or before December 15, 2009. From these proceeds the Company intends to replenish the trust fund it has with the Rader Firm with $1 million dollars to fund ongoing patent litigation. If funds are not completely expended, then the remaining cash balance in the trust fund will revert to the Company. Additionally, the Company estimates that it will have to pay federal and state taxes of approximately $1 to $1.5 million dollars related to this transaction.

ITEM 1A — RISK FACTORS

Item 1A ("Risk Factors") of our most recently filed Form 10-K sets forth information relating to important risks and uncertainties that could materially have an adverse effect on our business, financial condition, or operating results. In addition, the Company was given a "going concern" qualification by the Company's external auditors which raises doubt about the Company's ability to continue as a viable entity. There have been no material changes to the risk factors described in our most recently filed Form 10-K; however, those risk factors continue to be relevant to an understanding of our business, financial condition, and operating results, etc. Accordingly, potential and current investors should review and consider these risk factors in making any investment decision with respect to our securities. An investment in our securities continues to have a high degree of risk.

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

None.

ITEM 3 — DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5 — OTHER INFORMATION

None.

ITEM 6 — EXHIBITS

Exhibit No.	Description
3.01	Articles of Incorporation of LecTec Corporation, as amended (Incorporated herein by reference to the Company's Form S-1 Registration Statement (file number 33-9774C) filed on October 31, 1986 and amended on December 12, 1986).
3.02	Bylaws of LecTec Corporation (Incorporated herein by reference to the Company's Form S-1 Registration Statement (file number 33-9774C) filed on October 31, 1986 and amended on December 12, 1986).
31.01	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
31.02	Certification of Principle Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.01	Certification Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

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 16, 2009

By /s/ Judd A. Berlin
Judd A. Berlin
Chief Executive Officer, Chief Financial Officer, & Director
(Principal Executive Officer and Principal Financial Officer)

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
3.01	Articles of Incorporation of LecTec Corporation, as amended (Incorporated herein by reference to the Company's Form S-1 Registration Statement (file number 33-9774C) filed on October 31, 1986 and amended on December 12, 1986).
3.02	Bylaws of LecTec Corporation (Incorporated herein by reference to the Company's Form S-1 Registration Statement (file number 33-9774C) filed on October 31, 1986 and amended on December 12, 1986).
31.01	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
31.02	Certification of Principle Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.01	Certification Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

EXHIBIT 31.01

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Judd A. Berlin, certify that:

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

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

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

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principals;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 16, 2009

/s/ Judd A. Berlin
Judd A. Berlin
Chief Executive Officer

EXHIBIT 31.02

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Judd A. Berlin, certify that:

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

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

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

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principals;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 16, 2009

/s/ Judd A. Berlin
Judd A. Berlin
Chief Financial Officer

EXHIBIT 32.01

CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002 (SUBSECTIONS (A) AND (B) OF SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE)

In connection with the Quarterly Report of LecTec Corporation (the "Company") on Form 10-Q for the quarter ended September 30, 2009 as filed with the Securities and Exchange Commission (the "Report"), I, Judd A. Berlin, Chief Executive Officer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge that:

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

/s/ Judd A. Berlin

Judd A. Berlin
Chief Executive Officer
(Principal Executive and Financial Officer)
November 16, 2009