SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED JUNE 30, 1996.

[ ] 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 (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 ___X___ No _____

[ ] Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein; and will not be contained, to the best of the registrant's knowledge, in the definitive proxy statement incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of the voting stock held by non-affiliates of the registrant as of September 16, 1996 was $34,523,901.

The number of shares outstanding of the registrant's common stock as of September 16, 1996 was 3,835,989 shares.

Documents Incorporated by Reference	*10-K Parts Where Incorporated*
1. Definitive Proxy Statement for Annual Meeting of Shareholders of the Registrant to be held November 18, 1996.	*Part III*

PART I

Item 1. BUSINESS

GENERAL

LecTec Corporation (the "Company") designs, manufactures and markets diagnostic and monitoring ECG electrodes, conductive and non-conductive adhesive hydrogels, medical tapes, drug delivery patches and therapeutic products. The Company markets its products to original equipment manufacturers, medical products distributors, clinic and hospital purchasing groups, individual clinics and hospitals as well as electronic retailing and direct selling groups. All of the products manufactured by the Company are designed to be highly compatible with skin, the largest organ of the human body.

The Company developed one of the first solid gel disposable ECG

electrodes, which did not require the use of messy liquid, aqueous conductive gels in order to maintain contact with the skin. The Company has since continued to develop, manufacture and market electrodes, hydrogels, medical tapes, drug delivery systems, patches and therapeutic products. The Company holds domestic and foreign patents on various products.

The Company, through its research and development efforts, is developing new systems for drug delivery patches, new conductive-adhesive hydrogel polymers, medical tapes and therapeutic drugs, and refining existing technologies for new markets.

The Company was organized in 1977 as a Minnesota corporation. Its principal executive office is located at 10701 Red Circle Drive, Minnetonka, Minnesota 55343, and its telephone number is (612) 933-2291.

PRODUCTS

The Company applies its patented conductive and non-conductive adhesive hydrogels technology to cardiac diagnostic and cardiac monitoring electrodes. The Company's patented natural and synthetic-based polymers are self-adhesive and can be made electrically conductive. Using natural-based polymers, the Company developed one of the first solid gel disposable ECG electrodes. All of the Company's electrodes are electrically and chemically stable.

All of the Company's "skin-like" hydrogels are chemically compatible with human skin, thereby reducing or eliminating causative agents of skin irritation and reducing both damage to the skin and the risk of infection. The electrical and adhesive properties and the dimensions of the Company's products are highly consistent and reproducible from product to product because the conductive polymer is in a solid form, unlike some of the conductive gels used on competitive products. As a result of its proprietary technology the Company does not use toxic solvents in the manufacturing of its products. Solvents can cause dehydration of the skin, thereby causing damage to the skin as well as pain and discomfort to the patient. In addition, the use of this proprietary technology enables the Company to avoid certain environmental concerns associated with the use of harmful solvents in the manufacturing process.

Conductive Products

The Company's conductive products include diagnostic electrodes, monitoring electrodes, and electrically conductive and non-conductive adhesive hydrogels.

The Company's "Tracets"(R) diagnostic electrodes are snapless, disposable electrodes designed to replace reusable suction cups (Welsh bulbs) and conductive gels applied during routine electrocardiographs. Because Tracets electrodes are disposable, they pose less risk of cross infection than reusable suction cups. The solid gel and snapless design of the Tracets electrodes provide more consistent electrical performance and offer shorter procedure and clean-up time than Welsh bulbs. Currently the Company has three different types of Tracets diagnostic electrodes: T1000 Plus, a snapless disposable tab electrode made of natural polymer solid gel with gentle adhesion; MP 3000, a synthetic solid gel electrode with aggressive adhesion which meets all AAMI standards including defibrillation recovery; and AG 4000, a synthetic solid gel, silver substrate electrode which meets all AAMI standards including defibrillation recovery.

The Company's SynCor(R) monitoring electrodes are used for heart monitoring applications. These applications include surgical patients and hospitalized patients attached to bedside cardiac monitors. The SynCor product line consists of a specialized short term surgical electrode and a neo-natal product. The Company's short-term and neo-natal electrodes adhere without the use of tape. The Company introduced a new monitoring snap-type electrode in 1995, VitaTrace(TM) VT-10, composed of a synthetic solid state gel that meets all AAMI standards for adult use in bedside cardiac monitoring.

The Company manufactures synthetic and naturally-based hydrogels. The Company pioneered hydrogel technology and developed alternatives to competitors' hydrogels that are resistant to dehydration and evaporation problems and changes in their electrical and physical properties. The Company regulates the adhesive qualities of its hydrogels so that they can be used for attaching devices to the body. The hydrogels can be developed to deliver specific medications to the skin for topical use, or into or through the skin for localized or systemic application. Also, the hydrogels can be manufactured to have various levels of conductivity, with or without self-adhesive properties, for diagnostic and monitoring electrodes, electrosurgical grounding pads, external pacing and defibrillation electrodes, ultra-sonic gel pads, TENS products and iontophoretic return electrodes. Sales of conductive products accounted for approximately 61%, 52% and 58% of the Company's sales during its fiscal years ended June 30, 1996, 1995 and 1994.

Medical Tape Products

The Company manufactures and markets medical tape products of various types and configurations for the world market. The Company's medical tape business includes the U.S. healthcare market (hospitals and alternate care), the U.S. consumer market and the international healthcare market. Medical tape products manufactured and marketed by the Company are configured in both self-wound finished rolls and semi-finished master rolls. The Company's medical tape product line is comprised of the standard paper, plastic and cloth products widely used in the medical industry. The Company's trademarked products include

"Superpore(R)" Porous Paper Tape, "Isosilk(TM)" Cloth Tape and "Isoclear(TM)" Transparent Tape. All of the Company's tapes are hypoallergenic and utilize solvent-free adhesives.

The Company offers private label and converter alliance (selling of semi-finished goods to a manufacturer who then converts the goods into a finished product) programs. These programs offer customers quality products to compete successfully against established brand names. Private labeling tape products allows major medical marketers to penetrate markets offering significant volume potential with their own custom brand of medical tapes.

The Converter Alliance Program increases profitability and marketing opportunities for the Company's partners abroad. This program involves exporting semi-finished master rolls of medical tape to partners who convert the material into finished product, package the product and market it in a specific country. When product labeling and packaging is completed in the country where the product is sold, language and cultural barriers are reduced and packaging costs are often significantly lowered. Manufacturing partners benefit from using quality raw materials, market-oriented packaging, local labor content, established distribution channels, and connections with local Ministries of Health and other healthcare decision makers. Sales of medical tapes accounted for approximately 24%, 26% and 36% of the Company's sales in its fiscal years ended June 30, 1996, 1995 and 1994.

Therapeutic Products

The Company manufactures and markets drug delivery patches. The hydrogel-based patch products use a monolithic system that delivers drugs topically onto the skin. Products currently manufactured using the adhesive-based patch technology are wart removers, analgesic patches for localized pain relief and a corn and callus remover. These products are marketed as OTC (over-ther-counter) products. The Company, through its subsidiary, Pharmadyne Corporation (formerly Natus Corporation), markets the analgesic pain patches manufactured by the Company through a variety of distribution channels. Effective April 1, 1994, the Company consolidated Pharmadyne and its results of operations. Sales of therapeutic products accounted for approximately 15%, 22% and 6% of the Company's sales in each of the fiscal years ended June 30, 1996, 1995 and 1994.

CUSTOMERS

Burdick Corporation, ("Burdick") accounted for 17.0%, 14.6% and 17.4% of the Company's total sales during fiscal years 1996, 1995 and 1994, respectively. The Company sold its products to approximately 150 active customers during the fiscal years 1996 and 1995, down from approximately 240 active customers during fiscal year 1994. The decrease in active customers was the result of a marketing strategy to consolidate low volume customers with higher volume dealers and distributors in an effort to reduce total costs associated with order processing and shipping. The Company's backlog orders (purchase orders received from customers for future shipment) as of August 12, 1996 totaled approximately $1,318,500 (all of which the Company expects to fill), compared with approximately $2,184,800 and $1,807,900 on August 12, 1995 and 1994. The decrease in backlog at August 12, 1996 was primarily the result of a change in customer ordering patterns from placing standing purchase orders for multiple periods to placing individual purchase orders as needed.

GOVERNMENTAL REGULATION

Clinical testing, manufacturing, packaging, labeling and distribution of the Company's products are subject to FDA (Food and Drug Administration) regulation. Comparable agencies in some states and certain foreign countries also regulate the Company's activities. The Company's electrodes under current FDA policy are marketed pursuant to Section 510(k) notifications, which are simplified means of obtaining FDA approval to market a medical device. The Company's topical drug products are marketed under OTC monographs. The Company's `new drug' and transdermal `new drug' developments, may be marketed only after approval of a New Drug Application (NDA) containing full reports of extensive laboratory and clinical investigations on animals and humans.

The Company does not use toxic solvents in the manufacturing of its products and thus environmental concerns are reduced for the Company's manufacturing processes as compared with its competitors. The Company does not anticipate any major expenditures for environmental controls during the next year.

COMPETITION

The markets for electrodes, hydrogels, tapes, drug delivery patches and therapeutic products are highly competitive. Firms in the medical supply industry compete on the basis of product performance, pricing, distribution and service. Many of the Company's major competitors, including Minnesota Mining and Manufacturing Company (3M), have significantly greater financial, marketing and technological resources than the Company. Competitors of the Company most often rely on pricing, distribution or brand-name recognition to obtain sales. The Company believes that it competes successfully on the basis of product performance, cost savings in the use of patented technology and its ability to manufacture private label products for distributors and OEMs (Original Equipment Manufacturers).

Over the past several years there has been a number of mergers within the electrode and hydrogel industries, resulting in fewer but larger competitors. The Company believes its proprietary technology and manufacturing capabilities position it competitively in this market.

In recent years the Company has noted a reduction in the number of manufacturers of medical tapes. The Company believes this is due, in part, to the competitors' inability to satisfy increasingly stringent environmental requirements and market price pressures. This provides the Company an opportunity to increase its market share. The Company believes that it is one of the first medical tape companies manufacturing medical tapes without the use of harmful solvent-based adhesives or processing aids.

Schering-Plough (Dr. Scholl's) is the major competitor of two of the Company's therapeutic products, an OTC corn and callous remover and an OTC wart remover. Dr. Scholl's holds in excess of 85% market share for both products. The Company's OTC analgesic patch competes with ointments, lotions and creams manufactured by various competitors.

PATENTS AND TRADEMARKS

The Company has U.S. and foreign patents on adhesive membranes, electrode designs, transdermal and dermal delivery systems and tape structures. In the last year the Company was allowed four new U.S. patents. The first covered cotinine's utility in aiding smoke cessation and the second covered cotinine for weight management purposes. The third patent allowance covered a new non-occlusive adhesive patch for applying medication. The fourth covered a solid multi-purpose ultrasonic biomedical gel for diagnostic use. Eighteen U.S. and foreign patent applications are pending; additionally the Company has exclusive license for eight other patents. The patents most pertinent to the Company's major products have been issued and have a remaining duration in excess of eight years.

The Company expects that its products will be subject to continual modifications due to improvements in materials and rapid technological advances in the market for medical devices. Therefore, the Company's continued success does not depend only upon ownership of patents, but also upon technical expertise, creative skills and the ability to forge these talents into the timely release of new products into the marketplace.

The Company uses its best efforts to protect its proprietary property and information. In addition, the Company monitors competitive products and patent publications to be aware of potential infringement of its rights.

The Company has registered the following trademarks in the United States Patent and Trademark Office: LecPads, SPARE, Tracets, Superpore, Tree-Skin, ResTest II, VitaTrace, SME, LecTec and SynCor. The Company has filed for the registration of the tradenames UltraEase and Isoclear. The Company uses, but has not registered, the following tradenames: LecTrode, Isosilk, Isotex, Isopore, SME-5000, infiniti, Exten 238, DermaPhyl and "The Best ... Next to Skin.".

The Company's subsidiary, Pharmadyne Corporation, has registered the following tradenames in the United States Patent and Trademark Office: TheraPatch, Thermal Patch, HydroGesic Patch and ThermoGesic Patch.

RESEARCH AND DEVELOPMENT

The Company's research and development staff consists of professionals drawn from the business and academic communities with experience in the biological, chemical, pharmaceutical and engineering sciences. The research and development staff is responsible for the investigation, development and implementation of new technologies.

The Company may develop products jointly with corporations and/or with inventors from the academic world via research and development contracts or other forms of working alliances. Resulting products may then be marketed by the Company, by sponsoring partners or through a marketing arrangement with an appropriate distributor. R&D contract opportunities are evaluated on an individual basis.

Pilot clinical studies performed in previous years demonstrated encouraging results for our cotinine drug product used in smoking cessation for which the Company has exclusive license. The Addiction Research Center of the National Institute of Health (NIH) completed a study to determine if cotinine is addictive. The data was presented in June, 1996 at the CPDD (College on Problems of Drug Dependence) National Meeting. This data lends support to the notion that cotinine is behaviorally active and could mediate certain of the behavorial effects attributed to nicotine dependence. Minimal abuse potential (addiction potential) was detected. The encouraging clinical data gathered to date and the Company's positive patent developments have propelled this project out of the research phase and into the development phase which begins with a corporate sponsored IND (Investigational New Drug) application. Work on this submission continued throughout fiscal 1996 and the Company expects to file the IND in October 1996.

Research and development efforts are underway to complete the development of a new polymer-based reusable hydrogel. A 510(k) was awarded for the new UltraEase ultrasonic hydrogel couplant pad product.

The Company has developed a new proprietary coating process for the manufacture of porous medical tape products. The recently acquired and developed pressure sensitive adhesive coating and slitting production equipment, for the manufacturing of medical tapes employs two patent pending processes. Each of these two patent pending processes are used to manufacture LecTec's medical tape products.

R&D resources are also being used to fund development of new analgesic pain patch products, conductive products and specialized medical tapes.

In the fiscal years ended June 30, 1996, 1995 and 1994, the Company spent, approximately, $1,975,000, $1,877,000 and $1,380,000, respectively, on research and development.

MARKETING AND MARKETING STRATEGY

The Company markets and sells its products to original equipment manufacturers (OEM), medical product distributors, clinic and hospital purchasing groups, individual clinics and hospitals as well as electronic retailing and direct selling groups. The Company has focused on OEM accounts to build strategic partnerships with medical equipment and disposable supply manufacturers. Additionally, joint venture and marketing contracts are used to promote the Company's growth in therapeutic markets.

The Company has not experienced any significant seasonality in sales of its products.

The Company sells its products in the U.S., Canada, Europe, Asia, and portions of Latin America. Export sales totaled $2,425,904 (19% of total sales) in the fiscal year ended June 30, 1996, $2,603,349 (18% of total sales) in the fiscal year ended June 30, 1995 and $2,349,007 (22% of total sales) in the fiscal year ended June 30, 1994. The Company intends to continue to market its products internationally and expects international sales to remain approximately the same as a percent of total sales.

The Company's international sales are made by the Company's corporate sales force and the Company does not maintain a separate international marketing staff or operations. The following table sets forth export sales by geographic area (See Note J to the Financial Statements):

Export Sales	Years ended June 30		
	1996	1995	1994
Canada	$ 80,746	$ 113,597	$ 122,208
Europe	1,652,941	1,171,910	943,250
Asia	466,777	1,122,179	1,114,928
Latin America	225,440	195,663	168,621
Total Export Sales	$2,425,904	$ 2,603,349	$ 2,349,007

MANUFACTURING

The Company manufactures its conductive and therapeutic membranes at the Company's Minnetonka, Minnesota facility. The Minnetonka facility also manufactures and packages the Company's therapeutic products and conducts raw material processing operations. The Company's second manufacturing facility in Edina, Minnesota is the primary site for the manufacturing and packaging of medical tape and medical electrodes. The Edina location also provides the majority of the Company's warehouse capacity.

The Company believes that the raw materials used in manufacturing its products are generally available from multiple suppliers.

EMPLOYEES

As of June 30, 1996, the Company employed 76 full-time employees. None of the Company's employees are represented by any labor unions or other collective bargaining units. The Company believes its relations with its employees are good.

ACQUISITION OF PHARMADYNE CORPORATION (Formerly Natus Corporation)

During 1993, the Company invested $175,000 in Pharmadyne Corporation, which represented a 19.5% ownership interest in Pharmadyne. This investment was recorded at cost. In addition to this equity investment, the Company made cash advances to Pharmadyne during fiscal 1993 and 1994.

On April 1, 1994, the Company exercised an option to purchase 182,822 shares of Pharmadyne common stock at $1 per share increasing the ownership in Pharmadyne to 51%. This acquisition was accounted for as a stock purchase. The acquired goodwill of approximately $590,000 is being amortized on a straight-line basis over three years.

Effective April 1, 1994, the Company consolidated Pharmadyne in its results of operations.

During 1996 the Company made additional advances to Pharmadyne and received a warrant to purchase 227,959 additional shares of Pharmadyne at $1 per share. On September 5, 1996, the Company exercised the warrant and increased its ownership interest in Pharmadyne to 61%.

DISPOSITION OF DIRECT MARKETING RELATED ASSETS

On March 12, 1996, the Company contributed the direct marketing related assets of Pharmadyne to Natus L.L.C. (an Arizona limited liability company) in exchange for a 15% interest in Natus L.L.C. The direct marketing related assets contributed consisted of the following:

Accounts receivable	$ 32,791
Inventory	384,730
Prepaid expenses and other	135,708
Property and equipment, net	79,938
Other	(27,000)
	$606,167

Item 2. PROPERTIES

The Company owns a building located in Minnetonka, Minnesota, containing 18,000 square feet of office and laboratory space and 12,000 square feet of manufacturing and warehouse space. In addition, the Company leases a building in Edina, Minnesota containing 29,000 square feet.

Item.3. LEGAL PROCEEDINGS

None

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

None

PART II

Item 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company has been listed on the NASDAQ since December 17, 1986 and on the National Market System since June 7, 1988 under the trading symbol LECT.

The following table sets forth for the periods indicated the high and low prices of the Company's Common Stock. The figures reflect the high and low bid prices on the NASDAQ National Market System. Such prices reflect interdealer prices, without retail mark-up, mark-down, or commission, and may not necessarily represent actual transactions.

Years ended June 30,	1996		1995	
	High	Low	High	Low
First Quarter	$12.250	$8.500	$10.500	$7.000
Second Quarter	12.500	8.750	10.000	6.750
Third Quarter	12.000	9.875	11.000	7.250
Fourth Quarter	15.375	9.875	14.250	10.750

As of September 16, 1996 the Company had 3,835,989 shares of Common Stock outstanding and 399 shareholders of record.

The Company has not declared or paid cash dividends on its Common Stock since its inception, and intends to retain all earnings for use in its business for the foreseeable future.

Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

STATEMENT OF OPERATIONS DATA

<TABLE>
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Years ended June 30,	1996	1995	1994	1993	1992
<S>	<C>	<C>	<C>	<C>	<C>
Net sales	$13,100,754	$14,138,290	$10,715,490	$9,224,005	$8,101,954
Gross profit	4,969,659	5,697,562	4,041,853	3,434,128	3,290,005

Operating profit (loss)	(724,074)	69,761	837,161	750,335	1,153,802
Earnings (loss) before equity in losses of unconsolidated subsidiary	(632,193)	153,863	768,974	745,282	964,026
Equity in losses of unconsolidated subsidiary	---	---	(133,639)	(163,442)	---
Net earnings (loss)	(632,193)	153,863	635,335	581,840	964,026
Net earnings (loss) per share	(.17)	.04	.17	.15	.26

BALANCE SHEET DATA

At June 30,	1996	1995	1994	1993	1992
Cash, cash equivalents and short-term investments	$ 800,693	$ 839,942	$ 2,182,570	$ 3,469,632	$2,736,361
Current assets	5,449,682	5,764,363	6,124,640	6,082,934	5,480,921
Working capital	4,240,024	4,490,796	4,737,567	5,471,894	5,013,766
Property, plant and equipment, net	5,112,975	5,559,807	4,705,602	3,016,761	2,961,711
Long-term investments	574,806	568,156	585,855	3,016,761	1,143,605
Total assets	12,319,003	12,646,745	12,363,075	10,876,068	9,885,809
Long-term obligations	174,000	167,000	139,000	64,000	---
Shareholders' equity	10,935,345	11,206,178	10,837,002	10,201,028	9,418,654

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Earnings Summary

The Company reported a net loss of $632,000 or $.17 per share in fiscal 1996, a decrease from net earnings of $154,000 or $.04 per share in 1995 and down from net earnings of $635,000 or $.17 per share in 1994. The largest component of the net loss for 1996 was the losses associated with the direct marketing related operations of the Company's former Natus Corporation subsidiary. The 1996 net loss was also affected by increased R&D expenditures and decreased medical tape and therapeutic product sales which more than offset increased conductive product sales.

Results Of Operations
Sales

Sales totaled $13,101,000 in fiscal 1996, a decrease of 7% from $14,138,000 in 1995 and up from $10,715,000 in 1994. The reduction in sales in 1996 was primarily attributable to decreased therapeutic product sales resulting from the disposition of the direct marketing related assets of the Pharmadyne subsidiary as well as decreased medical tape sales which more than offset increased conductive product sales. The increase in sales from 1994 to 1995 was primarily attributable to increases in volume of all products sold.

Sales of conductive products (medical electrodes and conductive hydrogels) grew by 8% in fiscal 1996 to $7,940,000 from $7,334,000 in fiscal 1995. Conductive product sales were $6,015,000 in fiscal 1994. These increases were primarily attributable to unit volume increases.

Sales of medical tapes decreased by 14% in fiscal 1996 to $3,180,000 from $3,688,000 in fiscal 1995. Medical tape sales were $3,790,000 in fiscal 1994. The 1996 decrease was primarily attributable to reduced volume to a major international customer as compared to the prior year which more than offset the increased sales volume associated with new product offerings. The 1995 decrease was primarily attributable to a temporary slowdown in the purchasing volume of domestic self-wound finished roll medical tape customers in anticipation of new product offerings introduced during fiscal 1996.

Sales of therapeutic products decreased 36% in fiscal 1996 to $1,981,000 from $3,116,000 in fiscal 1995. Therapeutic product sales were $880,000 in fiscal 1994. The decrease in 1996 was primarily attributable to the decrease in the third quarter and the absence in the fourth quarter of the Pharmadyne Corporation (formerly Natus Corporation) direct marketing related sales due to the divestiture of the direct marketing related assets. The increase in 1995 was primarily attributable to increased sales of the over-the-counter analgesic patch products and the full year inclusion of Pharmadyne Corporation therapeutic product sales. Management believes the anticipated growth of the analgesic pain patch program will account for an increased proportion of the Company's sales mix during fiscal 1997.

International sales, consisting primarily of semi-finished conductive and medical tape products sold to overseas converters for final processing, packaging and marketing, were 19% of total sales in fiscal 1996, 18% in 1995 and 22% in 1994. The Company intends to continue to market its products internationally and expects international sales to remain approximately the same as a percent of total sales.

Gross Profit

The Company's gross profit totaled $4,970,000 in fiscal 1996, down from $5,698,000 in 1995. Gross profit was $4,042,000 in 1994. As a percentage of sales, gross profit was 37.9% in fiscal 1996, 40.3% in 1995 and 37.7% in 1994. In 1996, the decrease in the gross profit percent was primarily attributable to decreased sales of higher margin therapeutic products and increased overhead

costs. In 1995, the increased gross profit percent was primarily attributable to increased sales of higher-margin therapeutic products. The 1994 gross profit was affected by relatively high sales of lower-margin medical tape products.

Selling, General and Administrative Expenses

Selling, general and administrative expenses totaled $3,718,000 or 28.4% of sales in fiscal 1996, compared to $3,751,000 or 26.5% in 1995, and $1,825,000 or 17.0% in 1994. The 1996 decrease in expense was primarily the result of the absence of costs in the fourth quarter from the Pharmadyne Corporation direct marketing related operations which was partially offset by increases in other selling, general and administrative expenses. The 1995 increase was due primarily to the full year impact of the consolidation of Pharmadyne with the Company for fiscal 1995; the higher selling costs associated with the Pharmadyne direct selling organization; and the inclusion of goodwill amortization related to the acquisition of Pharmadyne.

Research and Product Development Expenses (R&D)

Research and product development expenses totaled $1,975,000 or 15.1% of sales in fiscal 1996, compared to $1,877,000 or 13.3% in 1995, and $1,380,000 or 12.9% in 1994. The high levels of R&D expenditures over this three-year period reflect the utilization of internally-generated funds to develop therapeutic products. Substantially all of the dollar increase in R&D during fiscal 1996 was associated with the clinical studies for the non-nicotine smoking cessation product. R&D resources are also being used to fund development of new analgesic pain patch products, conductive products and specialized medical tapes. Management believes that R&D expenditures, as a percentage of net sales, will remain in the range of 10% to 15% for the immediate future.

Other Income (Expense)

Other income totaled $54,000 in fiscal 1996, down from $73,000 in 1995 and $109,000 in 1994. In 1996 the decline resulted primarily from a reduction of interest income due to the prior year liquidation of short-term investments. In 1995 the decline resulted from the liquidation of short-term investments to finance research and product development efforts, the acquisition of a new therapeutic products production line plus increases in receivables and inventory necessary to support the growing business.

Income Tax Expense

The Company had income tax benefits of $38,000 in fiscal 1996 and $11,000 in 1995, compared to income tax expense of $177,000 in 1994. The tax benefit in 1996 resulted from losses incurred in the current year reduced by the effect of the subsidiary losses which cannot be utilized by the Company at this time and the effect of goodwill amortization. The tax benefit in 1995 was primarily attributable to R&D tax credits and alternative minimum tax credits.

Equity in Losses of Unconsolidated Subsidiary

On April 1, 1994, the Company acquired an additional 31.5% interest in Pharmadyne Corporation (formerly known as Natus Corporation) and began consolidating Pharmadyne's results of operations on that date. During the first nine months of fiscal 1994, the Company's pro-rata share of Pharmadyne's net loss (based on a 19.5% equity ownership position through March 31, 1994), together with goodwill amortization during the first nine months of the fiscal year, totaled $134,000.

Effect of Inflation

Inflation has not had a significant impact on the Company as it has generally been able to adjust its selling prices as the costs of materials and other expenses have changed

Liquidity and Capital Resources

Cash and cash equivalents decreased by $39,000 to $801,000 at June 30, 1996. Long-term investments increased by $7,000 to $575,000 at June 30, 1996. Capital spending for various equipment totaled $431,000 in 1996. There were no material commitments for capital expenditures at June 30, 1996.

Working capital totaled $4,240,000 at June 30, 1996, compared to $4,491,000 at the end of fiscal 1995. The Company's current ratio stood at 4.5 at the end of both fiscal 1996 and 1995.

Net property, plant and equipment decreased by $447,000 to $5,113,000 at June 30, 1996, reflecting the excess of depreciation expense over additions. Of this decrease, $80,000 was related to the disposition of the direct marketing related assets of Pharmadyne Corporation.

The Company is free of long-term debt, and has a $1,000,000 annually renewable revolving line of credit for meeting current operating requirements. There were no outstanding amounts on this short-term facility at the end of fiscal 1996. Shareholders' equity decreased by $271,000 to $10,935,000 at June 30, 1996.

Management believes that internally-generated cash and the existing short-term credit line will be sufficient for supporting anticipated growth and capital spending requirements in fiscal 1997.

Statements about the fiscal 1997 outlook are forward-looking and, therefore, involve certain risks and uncertainties, including but not limited to: buying patterns of customers, competitive forces and other factors detailed from time to time in filings with the Securities and Exchange Commission.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

LecTec Corporation and Subsidiaries Financial Statements Furnished Pursuant to the Requirements of Form 10-K

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Shareholders and
Board of Directors
LecTec Corporation

We have audited the accompanying consolidated balance sheets of LecTec Corporation and subsidiaries as of June 30, 1996 and 1995, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended June 30, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of LecTec Corporation and subsidiaries as of June 30, 1996 and 1995, and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended June 30, 1996, in conformity with generally accepted accounting principles.

Grant Thornton LLP

Minneapolis, Minnesota
August 26, 1996

<TABLE>
<CAPTION>

LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

JUNE 30,

ASSETS	1996	1995
<S>	<C>	<C>
CURRENT ASSETS		
Cash and cash equivalents (note A)	$ 800,693	$ 839,942
Receivables		
Trade, net of allowances of $74,208 in 1996 and $90,401 in 1995	1,847,736	1,955,584
Refundable income taxes	55,580	119,540
Other	182,247	268,247
	2,085,563	2,343,371
Inventories (note A)	2,011,327	2,097,254
Prepaid expenses and other	123,099	229,796
Deferred income taxes (note E)	429,000	254,000
Total current assets	5,449,682	5,764,363
PROPERTY, PLANT AND EQUIPMENT	--	
AT COST (note A)		
Building and improvements	1,629,630	1,603,447
Equipment	6,414,132	5,517,101
Furniture and fixtures	354,985	422,265
	8,398,747	7,542,813
Less accumulated depreciation	3,533,503	2,813,760

	4,865,244	4,729,053
Construction in progress	--	583,023
Land	247,731	247,731
	5,112,975	5,559,807
OTHER ASSETS		
Patents and trademarks, less accumulated amortization of $687,871 in 1996 and $554,286 in 1995 (note A)	417,681	386,470
Goodwill, less accumulated amortization of $442,503 in 1996 and $245,835 in 1995 (notes A and H)	147,497	344,165
Long-term investments (note B)	574,806	568,156
Investment in limited liability company (note I)	606,167	--
Other	10,195	23,784
	1,756,346	1,322,575
	$12,319,003	$12,646,745

The accompanying notes are an integral part of these statements.
</TABLE>

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LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS - CONTINUED

JUNE 30,

LIABILITIES AND SHAREHOLDERS' EQUITY	1996	1995
<S>	<C>	<C>
CURRENT LIABILITIES		
Accounts payable	$ 894,846	$ 771,471
Accrued expenses		
Payroll related	304,527	375,282
Distributor bonuses	--	71,384
Other	10,285	55,430
Total current liabilities	1,209,658	1,273,567
DEFERRED INCOME TAXES (note E)	174,000	167,000
COMMITMENTS AND CONTINGENCIES (notes D, F and G)	--	--
SHAREHOLDERS' EQUITY (note G)		
Common stock, $.01 par value; 15,000,000 shares authorized; issued and outstanding: 3,835,800 shares in 1996 and 3,786,500 shares in 1995	38,358	37,865
Additional paid-in capital	10,368,166	10,013,949
Unrealized losses on securities available-for-sale (note B)	(44,166)	(50,816)
Retained earnings	572,987	1,205,180
	10,935,345	11,206,178
	$ 12,319,003	$ 12,646,745

The accompanying notes are an integral part of these statements.
</TABLE>

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LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED JUNE 30,

	1996	1995	1994
<S>	<C>	<C>	<C>

Net sales (notes A and J)	$ 13,100,754	$ 14,138,290	$ 10,715,490
Cost of goods sold	8,131,095	8,440,728	6,673,637
Gross profit	4,969,659	5,697,562	4,041,853
Operating expenses			
Selling, general and administrative	3,718,496	3,751,194	1,825,121
Research and development	1,975,237	1,876,607	1,379,571
	5,693,733	5,627,801	3,204,692
Earnings (loss) from operations	(724,074)	69,761	837,161
Other income (expense)			
Interest income	26,554	35,846	89,498
Dividend income	38,029	38,487	60,433
Other	(10,702)	(1,231)	(41,118)
	53,881	73,102	108,813
Earnings (loss) before income taxes and equity in losses of unconsolidated subsidiary	(670,193)	142,863	945,974
Income tax expense (benefit) (note E)	(38,000)	(11,000)	177,000
Earnings (loss) before equity in losses of unconsolidated subsidiary	(632,193)	153,863	768,974
Equity in losses of unconsolidated subsidiary (note H)	--	--	(133,639)
Net earnings (loss)	$ (632,193)	$ 153,863	$ 635,335
Net earnings (loss) per common and common equivalent share (note A)	$ (.17)	$ .04	$ .17
Weighted average number of common and common equivalent shares outstanding during the year	3,801,155	3,826,905	3,803,439

The accompanying notes are an integral part of these statements.
</TABLE>

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LECTEC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
YEARS ENDED JUNE 30, 1996, 1995 AND 1994

	Shares	Common stock Amount	Additional paid-in capital
<S>	<C>	<C>	<C>
Balance, July 1, 1993	3,563,845	$ 35,638	$ 7,867,675
Net earnings	--	--	--
Cost of shares retired	(3,883)	(39)	(43,874)
Common stock issued upon exercise of options (note G)	18,366	184	68,768
Net unrealized loss on long-term marketable securities (note B)	--	--	--
Stock dividend	178,721	1,787	1,871,042
Tax benefit from exercise of stock options	--	--	45,468
Other	(49)	--	--
Balance, June 30, 1994	3,757,000	37,570	9,809,079
Net earnings	--	--	--
Cost of shares retired	(2,102)	(21)	(17,330)
Common stock issued upon exercise of options (note G)	31,602	316	162,200
Unrealized gain on securities available-for-sale (note B)	--	--	--
Tax benefit from exercise of stock options	--	--	60,000
Balance, June 30, 1995	3,786,500	37,865	10,013,949
Net loss	--	--	--
Cost of shares retired	(16,281)	(163)	(184,319)
Common stock issued upon exercise of options (note G)	65,581	656	450,536
Unrealized gain on securities available-for-sale	--	--	--

(note B)			
Tax benefit from exercise of stock options	--	--	88,000
Balance, June 30, 1996	3,835,800	$ 38,358	$ 10,368,166

[WIDE TABLE CONTINUED FROM ABOVE]

	Unrealized losses on securities available-for-sale	Retained earnings	Total shareholders' equity
Balance, July 1, 1993	$ (58,745)	$ 2,356,460	$ 10,201,028
Net earnings	--	635,335	635,335
Cost of shares retired	--	--	(43,913)
Common stock issued upon exercise of options (note G)	--	--	68,952
Net unrealized loss on long-term marketable securities (note B)	(2,219)	--	(2,219)
Stock dividend	--	(1,872,829)	--
Tax benefit from exercise of stock options	--	--	45,468
Other	--	(67,649)	(67,649)
Balance, June 30, 1994	(60,964)	1,051,317	10,837,002
Net earnings	--	153,863	153,863
Cost of shares retired	--	--	(17,351)
Common stock issued upon exercise of options (note G)	--	--	162,516
Unrealized gain on securities available-for-sale (note B)	10,148	--	10,148
Tax benefit from exercise of stock options	--	--	60,000
Balance, June 30, 1995	(50,816)	1,205,180	11,206,178
Net loss	--	(632,193)	(632,193)
Cost of shares retired	--	--	(184,482)
Common stock issued upon exercise of options (note G)	--	--	451,192
Unrealized gain on securities available-for-sale (note B)	6,650	--	6,650
Tax benefit from exercise of stock options	--	--	88,000
Balance, June 30, 1996	$ (44,166)	$ 572,987	$ 10,935,345

The accompanying notes are an integral part of these statements.
</TABLE>

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LECTEC CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30,

	1996	1995	1994
<S>	<C>	<C>	<C>
Cash flows from operating activities:			
Net earnings (loss)	$ (632,193)	$ 153,863	$ 635,335
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:			
Depreciation and amortization	1,128,103	932,051	584,362
Deferred income taxes	(80,000)	(149,000)	76,000
Equity in losses of unconsolidated subsidiary	--	--	133,639
Changes in operating assets and liabilities:			
Trade and other receivables	161,057	(410,006)	(297,085)
Refundable income taxes	63,960	109,714	(101,762)
Inventories	(298,803)	(325,219)	(811,246)
Prepaid expenses and other	(29,011)	(128,059)	(33,149)
Accounts payable	123,375	(189,057)	185,234
Accrued expenses	(187,284)	83,770	(19,109)
Net cash provided by operating activities	249,204	78,057	352,219
Cash flows from investing activities:			
Purchase of property, plant and equipment	(430,956)	(1,471,427)	(2,091,228)
Investment in patents and trademarks	(164,796)	(141,665)	(119,325)
Purchase of investments	--	(249,603)	(3,003,396)
Sale of investments	--	1,674,250	5,285,873
Acquisition of business, net of cash acquired	--	--	(182,822)

Other	40,589	19,395	85,656
Net cash used in investing activities	(555,163)	(169,050)	(25,242)
Cash flows from financing activities:			
Issuance of common stock	451,192	162,516	68,952
Retirement of common stock	(184,482)	(17,351)	(43,913)
Net cash provided by financing activities	266,710	145,165	25,039
Net increase (decrease) in cash and cash equivalents	(39,249)	54,172	352,016
Cash and cash equivalents at beginning of year	839,942	785,770	433,754
Cash and cash equivalents at end of year	$ 800,693	$ 839,942	$ 785,770
Cash paid during the year for income taxes	$ 33,199	$ 137,922	$ 178,316

The accompanying notes are an integral part of these statements
</TABLE>

LECTEC CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 1996, 1995 AND 1994

NOTE A - SUMMARY OF ACCOUNTING POLICIES

LecTec Corporation (the Company) is primarily engaged in the research, design, manufacture and sale of diagnostic and monitoring electrodes, membranes, medical tapes and therapeutic products. The Company sells and extends credit without collateral to customers located throughout the United States as well as Canada, Europe, Asia and Latin America. A summary of the Company's significant accounting policies consistently applied in the preparation of the accompanying financial statements follows:

1. Basis of Financial Statement Presentation

The consolidated financial statements include the accounts of LecTec Corporation ("LecTec"), LecTec International Corporation, a wholly-owned subsidiary, and Pharmadyne Corporation ("Pharmadyne," formerly known as Natus Corporation), a fifty-one percent owned subsidiary (note H). The Company has consolidated Pharmadyne's results of operations since April 1, 1994. All material intercompany accounts and transactions have been eliminated.

2. Cash and Cash Equivalents

The Company considers all highly liquid temporary investments with an original maturity of three months or less to be cash equivalents. Cash equivalents consist primarily of money market accounts.

3. Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market and consist of the following:

	June 30,	
	1996	1995
Raw materials	$1,144,078	$1,162,559
Work in process	229,974	218,351
Finished goods	637,275	716,344
	$2,011,327	$2,097,254

4. Depreciation and Amortization

Depreciation is provided in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives. The straight-line method of depreciation is followed for financial reporting purposes, and accelerated methods are used for tax purposes. Estimated useful lives used in the calculation of depreciation for financial statement purposes are:

Buildings and improvements	5 - 39 years

Equipment	*5 - 15 years*
Furniture and fixtures	*7 years*

The investment in patents and trademarks consists primarily of the cost of applying for patents and trademarks. Patents and trademarks are amortized on a straight-line basis over the estimated useful life of the asset, generally three to five years.

Goodwill represents the excess of cost over the fair value of net assets acquired and is amortized on a straight-line basis over three years.

5. Revenue Recognition

Sales are recognized at the time of shipment of product against a confirmed sales order.

6. Net Earnings (Loss) Per Common and Common Equivalent Share

Net earnings (loss) per common and common equivalent share have been computed by dividing net earnings (loss) by the weighted average number of common and common equivalent shares outstanding during the years. Common equivalent shares included in the computation represent shares issuable upon the assumed exercise of stock options, when dilutive.

7. Use of Estimates

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

8. Reclassifications

Certain 1995 and 1994 amounts have been reclassified to conform with the financial statement presentation used in 1996.

9. New Accounting Pronouncements

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) 123, "Accounting for Stock-Based Compensation," which establishes financial accounting and reporting standards for stock-based employee compensation plans. This Statement defines and encourages the use of a fair value based method of accounting for an employee stock option or similar equity instrument. The Statement allows the use of the intrinsic value based method of accounting as prescribed by current existing accounting standards for options issued to employees; however, there is a requirement to disclose the pro forma net income as if the fair value based method had been used. SFAS 123 is effective for fiscal years beginning after December 15, 1995. Management believes the adoption of SFAS 123 will not have a material effect on the Company's financial position or results of operations.

The FASB also issued SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," which establishes guidance for when to recognize and how to measure impairment losses of long-lived assets and certain identifiable intangibles, and how to value long-lived assets to be disposed of. SFAS 121 is effective for fiscal years beginning after December 15, 1995. Management believes the adoption of SFAS 121 will not have a material effect on the Company's financial position or results of operations.

NOTE B - INVESTMENTS

The Company's long-term investments are classified as available-for-sale and consist primarily of a preferred stock fund at June 30, 1996 and 1995. These investments are reported at fair value, with the net unrealized loss of $44,166 and $50,816 included in shareholders' equity at June 30, 1996 and 1995.

The Company utilizes the specific identification method in computing realized gains and losses.

NOTE C - LINE OF CREDIT

The Company has an unsecured $1,000,000 working capital line of credit through January 1, 1997 with interest at the bank's reference rate (effective rates of 8.25% and 9.0% at June 30, 1996 and 1995). There were no borrowings outstanding on the line at June 30, 1996 or 1995. The credit agreement

contains certain restrictive covenants which require the Company to maintain, among other things, specified levels of working capital and net worth and certain financial ratios. At June 30, 1996, the Company was in compliance with these covenants. Management believes the Company will be able to renew its line of credit under similar terms and conditions.

NOTE D - COMMITMENTS AND CONTINGENCIES

The Company conducts portions of its operations in a leased facility. The lease provides for payment of a portion of taxes and other operating expenses by the Company. This lease expires in 1997; however, management believes the Company will be able to renew this lease under similar terms and conditions.

The minimum rental commitments under all operating leases are as follows for the years ending June 30:

1997	$210,408
1998	7,910
	$218,318

Total rent expense for operating leases was $219,095, $223,147 and $218,375 for the years ended June 30, 1996, 1995 and 1994.

The Company is subject to various legal proceedings in the normal course of business. Management believes these proceedings will not have a material adverse effect on the Company's financial position or results of operations.

NOTE E - INCOME TAXES

Deferred tax assets and liabilities represent the tax effects, based upon current tax law, of future deductible or taxable items that have been recognized in the financial statements.

The provision for income tax expense (benefit) consists of the following:

	Years ended June 30,		
	1996	1995	1994
Current			
Federal	$ 40,000	$ 136,000	$ 99,000
State	2,000	2,000	2,000
	42,000	138,000	101,000
Deferred			
Federal	(80,000)	(149,000)	76,000
State	-	-	-
	(80,000)	(149,000)	76,000
	$(38,000)	$ (11,000)	$177,000

Deferred tax assets (liabilities) represent the tax effects of cumulative temporary differences as follows at June 30:

	1996	1995
Deferred current assets and liabilities:		
Net operating loss carryforwards	$ 538,200	$ 309,000
Tax credit carryforwards	161,100	141,100
Stock option exercise	88,000	-
Inventory capitalization and reserve	79,200	78,700
Vacation pay accrual	36,100	28,200
Other	7,400	6,000
	910,000	563,000
Valuation allowance	(481,000)	(309,000)
Net current asset	$ 429,000	$ 254,000

Deferred long-term assets and liabilities:

	1996	1995

Tax depreciation in excess of book depreciation	$(278,300)	$(256,900)
Charitable contribution carryforwards	57,100	51,700
Other	47,200	38,200
Net long-term liability	$(174,000)	$(167,000)

At June 30, 1996, Pharmadyne has available net operating loss carryforwards of approximately $1,400,000 which can be used to reduce future taxable income. These carryforwards begin to expire in 2009 and cannot be utilized to offset taxable income of LecTec. The utilization of these net operating loss carryforwards by Pharmadyne is restricted under Section 382 of the Internal Revenue Code due to past ownership changes. A valuation allowance has been recorded for these net operating loss carryforwards as they may not be realizable.

At June 30, 1996, LecTec has available tax credit carryforwards of approximately $161,000 which can be used to reduce future tax liabilities. These carryforwards begin to expire in 2010. LecTec also has available a net operating loss carryforward of approximately $168,000, which can be used to reduce future taxable income of LecTec. This carryforward expires in 2011.

Differences between income tax expense (benefit) and the statutory federal income tax rate of 34% are as follows:

	1996	1995	1994
Federal statutory income tax rate	(34.0)%	34.0%	34.0%
State income taxes, net of federal benefit	0.2	0.1	0.1
Tax credit carryforwards	-	(74.7)	(4.0)
Foreign sales corporation	(5.5)	(24.9)	(3.9)
Subsidiary loss producing no benefit	25.7	29.9	-
Tax exempt investment income	(0.8)	(14.7)	(5.1)
Goodwill amortization	10.0	46.8	1.8
Prior years' overaccruals	-	(4.8)	-
Other	(1.3)	.6	(4.2)
	(5.7)%	(7.7)%	18.7%

During the fourth quarter of the year ended June 30, 1995, the Company recorded a $131,000 reduction of income tax expense to adjust to the Company's annual effective tax rate. The effect of this adjustment was to increase net earnings per share by $.03 for the year.

NOTE F - EMPLOYEE BENEFIT PLANS

The Company has a profit sharing benefit plan covering substantially all employees who have completed one year of service. The Company's contributions are discretionary as determined by the Board of Directors, subject to certain limitations under the Internal Revenue Code. Pension expense under this plan was $55,585 and $46,918 for the years ended June 30, 1995 and 1994. No contributions were made to the plan during 1996.

The Company has a profit sharing bonus plan covering substantially all employees who have completed two calendar quarters of employment. The quarterly bonuses are paid from a pool equal to a maximum of 9% of pretax income net of certain reductions, including the profit sharing distribution, and a reserve based on the preceding quarter's net earnings. Profit sharing bonus expense under this plan was $2,820, $18,534 and $56,978 for the years ended June 30, 1996, 1995 and 1994.

The Company maintains a contributory 401(k) profit sharing benefit plan covering substantially all employees who have completed one year of service. The Company matches 50 percent of voluntary employee contributions to the plan not to exceed 50% of a maximum 5% of a participant's compensation. The Company's contributions under this plan were $44,549, $37,230 and $36,785 for the years ended June 30, 1996, 1995 and 1994.

NOTE G - STOCK OPTIONS

The Company's 1989 Stock Option Plan (the "Plan") provides for the grant of options to officers and other key employees of the Company. A total of 557,287 shares of common stock are reserved for issuance under the Plan. The ten-year options are exercisable at such times as set forth in the individual option agreements, generally vesting 100% after four years. The exercise price of the options granted is the fair market value of the Company's common stock at the date of grant. Option transactions under the Plan during the three years ended June 30, 1996 are summarized as follows:

	Number of shares	Option price of share

Outstanding at July 1, 1993	289,015	$3.34 - $ 9.07
Granted	132,914	8.62 - 9.52
Exercised	(16,391)	3.34 - 7.77
Canceled	(10,438)	3.34 - 9.52
Outstanding at June 30, 1994	395,100	3.34 - 9.52
Granted	107,000	9.00 - 13.00
Exercised	(31,492)	3.34 - 9.52
Canceled	(33,316)	3.34 - 9.52
Outstanding at June 30, 1995	437,292	3.34 - 13.00
Granted	121,500	9.00 - 13.50
Exercised	(65,663)	3.34 - 9.52
Canceled	(20,938)	3.34 - 9.52
Outstanding at June 30, 1996	472,191	$3.34 - $13.50

Under the Plan, options to purchase an aggregate of 212,441 shares were exercisable at June 30, 1996.

The Company's 1991 Directors' Stock Option Plan (the "Directors' Plan") provides for the grant of options to members of the Board of Directors of the Company. A total of 115,762 shares of common stock are reserved for issuance under the Directors' Plan. The ten-year options are exercisable at the date of the grant. The exercise price of the options granted is the fair market value of the Company's common stock at the date of grant. Option transactions under the Directors' Plan during the three years ended June 30, 1996 are summarized as follows:

	Number of shares	Option price of share
Outstanding at July 1, 1993	25,634	$3.34 - $9.06
Granted	7,875	9.52
Exercised	(2,895)	3.34
Outstanding at June 30, 1994	30,614	3.34 - 9.52
Granted	10,000	9.00
Exercised	(110)	7.77
Outstanding at June 30, 1995	40,504	3.34 - 9.52
Granted	12,000	9.00
Outstanding at June 30, 1996	52,504	$3.34 - $9.52

During the year ended June 30, 1996, the Company earned a tax benefit of $88,000 related to the exercise of stock options. As the benefit was not able to be utilized currently, the Company recorded a deferred tax asset and an increase in additional paid-in capital.

NOTE H - ACQUISITION OF PHARMADYNE CORPORATION

On June 30, 1992, the Company entered into a Research, Development and Marketing Agreement with Pharmadyne and contract research revenues of $125,000 and $75,000 were recognized in 1993 and 1992.

During 1993, the Company invested $175,000 in Pharmadyne, which represented a 19.5% ownership interest in Pharmadyne. This investment was recorded at cost. In addition to this equity investment, during 1993, the Company also made an advance of $50,000 to Pharmadyne. Effective March 28, 1994, the Company entered into a stock option agreement with Pharmadyne which provided the Company the right and option to purchase a number of shares of common stock of Pharmadyne that, when combined with the common stock already owned, would

equal, at the date of exercise, 51% of the issued, outstanding and potentially issuable shares of common stock.

On April 1, 1994, the Company exercised their option to purchase 182,822 shares of Pharmadyne common stock at $1 per share. The Company paid cash of $132,525 and reduced their note receivable from Pharmadyne by $50,000 and interest receivable by $297 to acquire the shares. This acquisition was accounted for as a purchase. The acquired goodwill of approximately $590,000 is being amortized on a straight-line basis over 3 years.

The following unaudited pro forma consolidated results of operations for the year ended June 30, 1994 give effect to the acquisition of Pharmadyne as though it had occurred on July 1, 1993:

	1994
Net sales	$11,501,000
Earnings before income taxes	347,000
Net earnings	178,000
Net earnings per common and common equivalent share	.05

During 1996 the Company made additional advances to Pharmadyne and received a warrant to purchase 227,959 additional shares of Pharmadyne at $1 per share. On September 5, 1996 the Company exercised the warrant and increased its ownership interest in Pharmadyne to 61%.

NOTE I - DISPOSITION OF DIRECT MARKETING RELATED ASSETS

On March 12, 1996, the Company contributed the direct marketing related assets of Pharmadyne to Natus L.L.C. (an Arizona limited liability company) in exchange for a 15% interest in Natus L.L.C. The direct marketing related assets contributed consisted of the following:

Accounts receivable	$ 32,791
Inventory	384,730
Prepaid expenses and other	135,708
Property and equipment, net	79,938
Other	(27,000)
	$606,167

NOTE J - MAJOR CUSTOMERS AND EXPORT SALES

One customer accounted for 17.0%, 14.6% and 17.4% of total sales for the years ended June 30, 1996, 1995 and 1994. The accounts receivable from this customer represented 24% of trade receivables at June 30, 1996. The accounts receivable from one other customer represented 15% of trade receivables at June 30, 1996. One additional customer accounted for 10.1% of total sales during the year ended June 30, 1994. Export sales accounted for approximately 19%, 18% and 22% of total sales during the years ended June 30, 1996, 1995 and 1994. Export sales by geographic area were as follows:

	Years ended June 30,		
	1996	1995	1994
Canada	$ 80,746	$ 113,597	$ 122,208
Europe	1,652,941	1,171,910	943,250
Asia	466,777	1,122,179	1,114,928
Latin America	225,440	195,663	168,621
	$2,425,904	$2,603,349	$2,349,007

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required under this item with respect to directors will be included under the heading "Election of Directors" in the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held November 18, 1996, and is incorporated herein by reference.

NON DIRECTOR, EXECUTIVE OFFICERS OF THE REGISTRANT

Name	Age	Title

Erwin W. Templin II	43	Executive Vice President, Chief Financial Officer, Secretary and Treasurer
David A. Montecalvo	31	Vice President, Operations

Erwin W. Templin II is Executive Vice President, Chief Financial Officer, Secretary and Treasurer. Mr. Templin joined the Company in July, 1993 as a Vice President of the Company and served as a director from 1990 to 1995. From 1991 to 1993, he was Senior Vice President and Chief Financial Officer of Aviation Services Holdings, Inc., a privately held general aviation investment company. From 1988 to 1990, Mr. Templin was Senior Vice President and Chief Financial Officer of Van Dusen Airport Services Company. Prior to 1988, he served in various financial management positions with H.B. Fuller Company and Jostens, Inc.

David A. Montecalvo is Vice President, Operations. Mr. Montecalvo joined the Company in 1986 and held the position of Director, Corporate Science and Technology prior to July 1995, when he became the Vice President, Operations.

Item 11. EXECUTIVE COMPENSATION

The information required under this item will be included under the heading "Executive Compensation" in the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held November 18, 1996, and is incorporated herein by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required under this item will be included under the heading "Security Ownership of Certain Beneficial Owners and Management" in the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held November 18, 1996, and is incorporated herein by reference.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information required under this item with respect to certain relationships and related transactions will be included under the heading "Certain Relationships and Related Transactions" in the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held on November 18, 1996, and is incorporated herein by reference.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Financial Statements, Schedules and Exhibits

1. Financial Statements

The following consolidated financial statements of the Company and its subsidiaries are filed as a part of this Form 10-K in Part II, Item 8:

(i) Report of Independent Certified Public Accountants

(ii) Consolidated Balance Sheets at June 30, 1996 and 1995

(iii) Consolidated Statements of Operations for the years ended June 30, 1996, 1995 and 1994

(iv) Consolidated Statements of Shareholders' Equity for the years ended June 30, 1996, 1995 and 1994

(v) Consolidated Statements of Cash Flows for the years ended June 30, 1996, 1995 and 1994

(vi) Notes to the Consoldiated Financial Statements

2. Financial Statement Schedules :

All schedules have been omitted since the required information is not present or not present in amounts sufficient to require submission of the schedule, or because the information required is included in the financial statements or the notes thereto.

<TABLE>
<CAPTION>

3. Exhibits		Method of Filing
<S>	<C>	<C>
3.01	Articles of Incorporation of Registrant, as amended	(1)
3.02	By-laws of Registrant	(1)

10.01	*Service Agreement dated July 1, 1986, between LecTec International, Inc., a U.S. Virgin Islands corporation, and LecTec Corporation, relating to the sale, lease or rental of certain property outside the United States.*	*(1)*
10.02	*Distribution and Commission Agreement dated July 1, 1986, between LecTec International, Inc., a U.S. Virgin Islands corporation, and LecTec Corporation, relating to the sale, lease or rental of certain property outside the United States.*	*(1)*
10.03	*1986 Incentive Stock Option Plan*	*(1)*
10.04	*Agreement dated June 1, 1983, between LecTec Corporation and George Ingebrand, relating to the grant of stock-equivalent units.*	*(1)*
10.05	*Certificate of Secretary pertaining to Resolution of Board of Directors of LecTec Corporation, dated October 30, 1986, implementing a Profit Sharing Bonus Plan.*	*(1)*
10.06	*Research Agreement dated December 31, 1991, between LecTec Corporation and the University of Minnesota, whereby LecTec Corporation received exclusive rights to market and sell a non-nicotine compound to be mutually developed for smoking cessation.*	*(2)*
10.07	*Assignment and Mutual Release Agreement dated March 9, 1993 between Pharmaco Behavioral Associates, Inc., Robert M. Keenan, Ph.D., M.D. and the University of Minnesota, whereby the University assigned title, royalty and patent rights associated with the technology to alleviate symptoms of tobacco withdrawal to Pharmaco Behavioral Associates, Inc. and Dr. Keenan. Also included is a mutual release of all parties on all past title, royalty and patent rights.*	*(2)*
10.08	*License Agreement dated March 9, 1993 between Pharmaco Behavioral Associates, Inc. and LecTec Corporation, whereby the Company received an exclusive, worldwide license to market, make and sublicense product associated with the technology to alleviate symptoms of tobacco withdrawal.*	*(2)*
10.09	*Consultant Contract and Invention Assignment dated March 9, 1993 between Robert Keenan, Ph.D., M.D. and LecTec Corporation, whereby the Company received assignment of patent and invention rights associated with the technology to alleviate symptoms of tobacco withdrawal including provisions that the Company enter into a consulting agreement with Dr. Keenan.*	*(2)*
10.10	*Research Agreement dated June 30, 1992, between LecTec Corporation and Natus Corporation, whereby Natus will fund the the development of an analgesic patch for exclusive rights to sell the the product.*	*(2)*
10.11	*Stock Investment and Repurchase Agreement dated July 1, 1992, between LecTec Corporation and Natus Corporation, whereby LecTec purchased Common Stock of Natus Corporation.*	*(2)*
10.12	*Amendments dated March 18, 1993 to the original Research Agreement dated June 30, 1992, between LecTec Corporation and Natus Corporation.*	*(2)*
10.13	*Subscription Agreement dated June 17, 1993 between LecTec Corporation and Natus Corporation.*	*(2)*
10.14	*A Promissory Note dated June 17, 1993 between LecTec Corporation and Natus Corporation. Included in the note is an option for LecTec to receive common stock of Natus in lieu of payment.*	*(2)*
10.15	*Amended and Restated Stock Option Agreement between LecTec Corporation and Natus Corporation, whereby LecTec has obtained the option to acquire the additional shares required to equal 51% of the Common Stock of Natus.*	*(3)*
10.16	*Contribution Agreement dated March 12, 1996 between Natus Corporation and ACM Investments, L.L.C. regarding the acquisition of an equity interest in Natus L.L.C*	*(4)*
**10.17*	*Distribution Agreement dated March 12, 1996 between LecTec Corporation, Natus Corporation and Natus*	*(4)*

		L.L.C.	
	10.18	Operating Agreement dated March 12, 1996 between Natus L.L.C., ACM Investments, L.L.C., Natus Corporation and Natus Management, Inc.	(4)
	*10.19	Marketing and Distribution Agreement dated January 11, 1996 between LecTec Corporation, Natus Corporation and CNS, Inc. regarding an analgesic pain patch	(4)
	10.20	Credit Agreement dated May 1, 1996 between LecTec Corporation and The First National Bank of Saint Paul, a national banking association, whereby LecTec Corporation has an unsecured $1 million working capital line of credit	(4)
	10.21	Revolving Credit Note dated May 1, 1996 between LecTec Corporation and The First National Bank of Saint Paul, a national banking association	(4)
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	10.23	Form of Working Capital Loan Agreement dated September 5, 1995; between Natus Corporation and various shareholders relating to loans to Natus Corporation	(4)
	21.01	Subsidiaries of the Company	(3)
	23.01	Consent of Grant Thornton LLP	(4)
	27.01	Financial Data Schedule	(4)

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* Confidential treatment requested for portions of this Exhibit pursuant to Rule 24b-2 under the Securities Exchange Act of 1934 as amended, the confidential portions have been deleted and filed separately with the Securities and Exchange Commission together with a confidential treatment request

(1) Incorporated herein by reference to the Company's Form S-18 Registration Statement (file number 33-9774C) filed on October 31, 1986 and amended on December 12, 1986.

(2) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 1993.

(3) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 1994.

(4) Filed herewith.

(b) 1. Reports on Form 8-K.

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on the 27th day of September, 1996.

LECTEC CORPORATION

/s/Rodney A. Young

Rodney A. Young
Chief Executive Officer, President
and Director
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

/s/Rodney A. Young — September 27, 1996

Rodney A. Young
Chief Executive Officer, President
Director
(Principal Executive Officer)

/s/Erwin W. Templin II — *September 27, 1996*

Erwin W. Templin II
Executive Vice President, Chief Financial Officer, Secretary, Treasurer
(Principal Financial Officer)

/s/Justin W. Shireman — *September 27, 1996*

Justin W. Shireman
Controller
(Principal Accounting Officer)

/s/Thomas E. Brunelle — *September 27, 1996*

Thomas E. Brunelle
Chairman
Director

/s/Alan C. Hymes — *September 27, 1996*

Alan C. Hymes
Director

/s/Lee M. Berlin — *September 27, 1996*

Lee M. Berlin
Director

/s/Paul Johnson — *September 27, 1996*

Paul Johnson
Director

/s/Alan J. Wilensky — *September 27, 1996*

Alan J. Wilensky
Director

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(3) *Incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 1994.*

CONTRIBUTION AGREEMENT

by and among

NATUS CORPORATION, a Minnesota corporation

and

ACM INVESTMENTS, L.L.C., an Arizona limited liability company

Dated March 12, 1996

CONTRIBUTION AGREEMENT

THIS CONTRIBUTION AGREEMENT is entered into by and between Natus Corporation, a Minnesota corporation ("Old Natus"), and ACM Investments, L.L.C., an Arizona limited liability company ("ACM"). This Agreement and the Operating Agreement are entered into and shall be effective simultaneously with each other as of this, the 12th day of March, 1996 ("Contribution Date").

RECITALS

A. Old Natus is engaged in the Business (as defined below).

B. Old Natus desires to obtain additional capital and financing with respect to the Business.

C. ACM desires to provide additional capital and financing with respect to the Business, and to acquire an interest in the Business.

In consideration of the foregoing and the mutual representations, warranties, covenants, and agreements herein contained, Old Natus and ACM agree as follows:

Article 1
DEFINITIONS

Unless otherwise defined herein, capitalized terms used in this Agreement that are defined in the Operating Agreement are used herein as so defined. For the purpose of this Agreement, the following terms have the following meanings:

"ACM" means ACM Investments, L.L.C., an Arizona limited liability company.

"Affiliate" shall have the meaning set forth in Section 1.7 of the Operating Agreement.

"Agreement" means this Contribution Agreement, as it may be amended from time to time, complete with all Schedules hereto.

"Balance Sheet" shall have the meaning set forth in Section 6.6 of this Agreement.

"Balance Sheet Date" shall have the meaning set forth in Section 6.6 of this Agreement.

"Business" shall mean the business of Old Natus in (i) direct selling

(by virtue of multi-level marketing or otherwise) and distribution of skin-care products, vitamins and related products, and (ii) the marketing and distribution of Patches in the Exclusive Market, as such terms are defined in the Distribution Agreement.

"Business Assets" shall have the meaning set forth in Section 3.1 of this Agreement.

"Capital Contribution" shall mean the Capital Contributions of Old Natus and ACM as set forth in Sections 2.2 and 2.3 of this Agreement.

"Claims" shall have the meaning set forth in Section 3.1(d) of this Agreement.

"Code" means the Internal Revenue Code of 1986, as amended.

"Contribution Date" shall have the meaning set forth in the Preamble to this Agreement.

"Conveyance Instruments" shall have the meaning set forth in Section 4.2 of this Agreement.

"Co-Sale Notice" shall have the meaning set forth in Section 9.2 of this Agreement.

"Distribution Agreement" means that certain Distribution Agreement of even date by and among Old Natus, New Natus and LecTec Corporation, a Minnesota corporation, as it may be amended from time to time, complete with Schedules thereto.

"Encumbrances" shall have the meaning set forth in Section 4.1 of this Agreement.

"Equipment" shall have the meaning set forth in Section 3.1(a) of this Agreement.

"Exercise Notice" shall have the meaning set forth in Section 9.2 of this Agreement.

"Exercise Period" shall have the meaning set forth in Section 9.2 of this Agreement.

"Indemnitee" shall have the meaning set forth in Section 8.1(b) of this Agreement.

"Indemnitor" shall have the meaning set forth in Section 8.1(b) of this Agreement.

"Intangible Property" shall have the meaning set forth in Section 3.1(c) of this Agreement.

"Inventory" shall have the meaning set forth in Section 3.1(b) of this Agreement.

"Law" or "Laws" shall have the meaning set forth in Section 6.15 of this Agreement.

"Merchant Account" shall have the meaning set forth in Section 4.3 of this Agreement.

"Mishkin" shall mean Alan R. Mishkin.

"Mishkin Affiliate" shall mean:

(a) Mishkin;

(b) any Affiliate of Mishkin;

(c) any member of Mishkin's immediate family; or

(d) any trust established by Mishkin for the benefit of any other Mishkin Affiliate.

"Mishkin Interests" shall have the meaning set forth in Section 9.1.

"New Natus" means Natus, L.L.C., a limited liability company to be formed pursuant to the laws of the state of Arizona.

"Old Natus" means Natus Corporation, a Minnesota corporation.

"Operating Agreement" means the Operating Agreement of New Natus.

"Pre-Contribution Tax Period" means any tax period ending on or before the close of business on the Contribution Date, or, in the case of any tax period which includes, but does not end on, the Contribution Date, the portion of such period up to and including the Contribution Date.

"Receivables" shall have the meaning set forth in Section 3.1(f).

"Restricted Sale" shall have the meaning set forth in Section 9.1.

"Returns" shall have the meaning set forth in Section 6.8(a)(i).

"Tax" means (i) any net income, alternative or add-on minimum tax, gross income, gross receipts, sales, use, ad valorem, franchise, capital, paid-up capital, profits, greenmail, license, withholding, payroll, employment, excise, severance, stamp, occupation, premium, property, environmental or windfall profit tax, custom, duty, or other tax, governmental fee, or other like assessment or charge of any kind whatsoever, together with any interest or any penalty, addition to tax, or additional amount imposed by any governmental authority responsible for the imposition of any such tax (domestic or foreign), and (ii) liability for the payment of any amounts of the type described in (i) as a result of any express obligations to indemnify any other Person.

Article 2
FORMATION OF NEW NATUS

2.1 Formation of New Natus. ACM shall form New Natus, on behalf of ACM and Old Natus.

2.2 Capital Contribution of Old Natus. Old Natus shall contribute, as a contribution to the capital of New Natus, the Business, pursuant to the terms of this Agreement, in exchange for a fifteen percent (15%) interest in the profits and losses of New Natus, and an interest in the distributions and capital of New Natus as set forth in Section 2.6 of this Agreement. The net value of Old Natus's capital contribution (as reflected on the Balance Sheet) is _____ Dollars ($_____), which amount shall be adjusted to reflect changes in the components of the Balance Sheet as of the Contribution Date made in the ordinary course of business.

2.3 Capital Contribution of ACM. ACM shall contribute an amount not to exceed the sum of One Million and No/100ths Dollars ($1,000,000.00) in cash to the capital of New Natus on an "if and as needed basis," provided, however, that within six (6) months, Natus Manager (as defined in Section 2.5 hereof) shall prepare a business plan and budget ("Budget") reflecting the intent of the parties hereto to increase the business of New Natus, and thereafter, ACM shall contribute such amounts to the capital of New Natus as required by the Budget of New Natus (provided New Natus achieves the anticipated results set forth in the Budget) in exchange for an eighty-five percent (85%) interest in the profits and losses of New Natus, and an interest in the distributions and capital of New Natus as set forth in Section 2.6 of this Agreement.

2.4 Change of Name. Old Natus shall, simultaneously with the closing of the transactions contemplated by this Agreement, change its name to a name not using the tradename "Natus" or any other tradename transferred to New Natus pursuant to the terms of this Agreement.

2.5 Management of New Natus. New Natus shall be a manager-managed limited liability company. The manager of New Natus shall be a new Arizona corporation to be formed ("Natus Manager"), which will be owned eighty-five percent (85%) by ACM and fifteen percent (15%) by Old Natus. The initial Board of Directors of Natus Manager will be comprised of four members, at least three of whom shall be elected by ACM. For such time as (a) the aggregate amount of cash and the aggregate Gross Asset Value of any New Natus property distributed

to Old Natus pursuant to any provision of the Operating Agreement is less than the Capital Contributions of Old Natus, or (b) the Distribution Agreement remains in full force and effect as to Old Natus and New Natus, Old Natus shall have the right to elect one member to the Board of Directors of Natus Manager, subject to the approval of such proposed member by the majority shareholder of Natus Manager. Alan R. Mishkin shall be the Chairman of the Board of Directors of Natus Manager. New Natus shall have the following officers:

Officer	*Office*
Alan R. Mishkin	*Chief Executive Officer*
Richard J. Bennetts	*President*
Kathleen Billings	*Vice President--Marketing and Products Development*
Ryan Wuerch	*Vice President--Sales*
Stanley Lumpp	*Vice President--Distribution*

2.6 New Natus Distributions.

(a) ACM and Old Natus anticipate that in the first years of operation, net cash flow of New Natus may not be distributed, but instead may be reinvested in the Business. To the extent cash from operations is available for distribution, such cash shall be distributed to the Members in accordance with their Membership Interests.

(b) If New Natus sells all or substantially all of the Business or its assets, or upon a liquidation of New Natus, the net proceeds from such sale or liquidation shall be distributed in accordance with Section 9.3 of the Operating Agreement.

Article 3
BUSINESS ASSETS AND LIABILITIES

3.1 Assets Included. The "Business Assets" shall consist of all right, title and interest of Old Natus as of the Contribution Date in and to the following specifically identified assets:

(a) all equipment, furniture, and other tangible property used in connection with the Business as listed in Schedule 3.1(a) of this Agreement (collectively, "Equipment");

(b) the raw materials, finished goods, work-in-process, supplies, and inventories of Old Natus as described in Schedule 3.1(b) hereto (collectively, "Inventory");

(c) those patents, copyrights, trademarks, trade names, technology, know-how, processes, trade secrets, inventions, proprietary data, formulae, research and development data, computer software programs, and other intangible property, and any applications for the same, used by Old Natus in the Business as described in Schedule 3.1(c) of this Agreement, and all goodwill associated with such intangible property (collectively, "Intangible Property");

(d) all of Old Natus's rights, claims, credits, causes of action, or rights of setoff against third parties relating to the Business, including, without limitation, unliquidated rights under manufacturers' and vendors' warranties as described in Schedule 3.1(d) hereto (collectively, "Claims");

(e) those contracts, agreements, leases, licenses, and other instruments, arrangements, and commitments being assumed by New Natus with respect to the Business Assets, including without limitation all distributors of the Business, as set forth on Schedule 3.1(e) of this Agreement;

(f) all accounts receivable arising out of sales in the ordinary and usual course of the operation of the Business prior to the close of business on the Contribution Date (collectively, "Receivables"), as set forth in Schedule 3.1(f) of this Agreement;

(g) all prepaid expenses arising from payments made by Old Natus in the ordinary and usual course of the operation of the Business prior to the close of business on the Contribution Date for goods or services,

as set forth in Schedule 3.1(g) of this Agreement;

(h) all payments received by Old Natus with respect to products of the Business that have not been shipped as of the Contribution Date, as set forth in Schedule 3.1(h) of this Agreement;

(i) originals or copies of all books, records, files, and papers, whether in hard copy or computer format, used in the Business, including without limitation, manuals and data, sales and advertising materials, sales and purchase correspondence, lists of present and former suppliers, and personnel and employment records and, with respect to information relating to Tax, any information that is necessary for the preparation of any Tax returns to be filed by New Natus after the Contribution Date or the determination of the Tax basis of the Business Assets; and

(j) all lists of present, and, to the extent available, future distributors, customers and suppliers associated with the Business Assets, as set forth in Schedule 3.1(j) of this Agreement.

3.2 Liabilities of Old Natus. New Natus shall not assume any liabilities whatsoever of Old Natus other than the obligations of Old Natus with respect to the outstanding and unfilled purchase orders described in Schedule 3.2 hereto. Old Natus shall pay all of its liabilities not assumed by New Natus and not contested in good faith.

Article 4
CONTRIBUTION OF ASSETS BY OLD NATUS

4.1 Contribution of the Business Assets. Subject to the terms and conditions of this Agreement, on the Contribution Date, Old Natus shall assign, transfer, and deliver to New Natus, as a Capital Contribution, free and clear of all title defects, objections, liens, pledges, claims, rights of first refusal, options, charges, security interests, mortgages, or other encumbrances of any nature whatsoever (collectively, "Encumbrances"), but on an "as is, where is" basis (except as otherwise set forth in Sections 6.2, 6.7, 6.8, 6.9, 6.10, 6.11, 6.12, 6.16, 6.17, 6.18, and 8.2 herein and the Schedules hereto) all of the Business Assets.

4.2 Conveyance Instruments. To effectuate the contribution of the Business Assets as contemplated by this Article 4, Old Natus will hereafter, execute and deliver, or cause to be executed and delivered, all such documents or instruments of assignment, transfer, or conveyance, in each case dated the Contribution Date (collectively, "Conveyance Instruments"), as the parties and their respective counsel shall reasonably deem necessary or appropriate to vest in or confirm title to the Business Assets to New Natus.

Article 5
EVENTS OCCURRING ON THE CONTRIBUTION DATE

5.1 Deliveries by Old Natus. On the Contribution Date, Old Natus shall deliver to ACM and New Natus the following:

(a) the Conveyance Instruments to effect the contribution of the Business Assets to New Natus, such Conveyance Instruments to be those reasonably deemed necessary by, and to be in form and substance reasonably satisfactory to, counsel to the parties;

(b) a copy of the resolution of the Board of Directors of Old Natus, certified by its Secretary, approving the transfer of the Business Assets to New Natus;

(c) a certificate from Old Natus stating that, to the best of its information and belief, its representations and warranties are true, complete, and accurate in all material respects at and as of the Contribution Date;

(d) an executed copy of the Operating Agreement;

(e) a copy of the Distribution Agreement executed by LecTec Corporation and Old Natus;

(f) the executed counterpart copies of all consents, approvals, authorizations, and permits, if any, from third parties required to be obtained to effectuate the conveyance of the Business Assets;

(g) the opinions of counsel for Old Natus as described in Schedule 5.1(g) hereto, dated the Contribution Date, in form and substance reasonably satisfactory to counsel for ACM;

(h) all other previously undelivered items required to be delivered by Old Natus at or prior to the Contribution Date pursuant to the terms of this Agreement and the Operating Agreement.

5.2 Deliveries by ACM. On the Contribution Date, ACM shall deliver to Old Natus and New Natus the following:

(a) an executed copy of the Operating Agreement;

(b) an executed copy of the Distribution Agreement;

(c) a copy of the Articles of Organization of ACM;

(d) a copy of the Articles of Organization of New Natus;

(e) the opinions of counsel for New Natus as described in Schedule 5.2(d) hereto, dated the Contribution Date, in form and substance reasonably satisfactory to counsel for Old Natus;

(f)a copy of the Articles of Incorporation and Bylaws of Natus Manager; and

Article 6
REPRESENTATIONS AND WARRANTIES OF OLD NATUS

6.1 Due Authorization. Old Natus is a corporation duly formed and organized, validly existing and in good standing under the laws of the State of Minnesota, and has the requisite corporate power and authority to own its assets and carry on its business as such business has been conducted.

6.2 Title to the Business Assets. As of the Contribution Date, Old Natus will have good and marketable title to the Business Assets free and clear of all Encumbrances.

6.3 Qualification. Old Natus is licensed or qualified to do business as a foreign corporation and is in good standing in the jurisdictions in which it conducted its business (except where the failure to so qualify would not have a material adverse effect on the business or financial condition of the Business taken as a whole).

6.4 Valid, Binding and Enforceable. This Agreement constitutes, and each other agreement or instrument to be executed and delivered by Old Natus pursuant to the terms of this Agreement, when executed by ACM, will constitute, the legal, valid and binding obligation of Old Natus, enforceable against Old Natus in accordance with its terms, except as limited by applicable bankruptcy, reorganization, arrangement, insolvency, moratorium or similar laws affecting the enforcement of creditors' rights.

6.5 No Violations. Neither the execution or delivery of this Agreement or the Operating Agreement nor the consummation of the transactions contemplated hereby or thereby:

(a) requires any filing or registration with, or consent, authorization, approval, or permit of, any governmental or regulatory authority on the part of Old Natus;

(b) violates or will violate (i) any order, writ, injunction, judgment, decree, or award of any court or governmental or regulatory authority or (ii) to the knowledge of Old Natus, violates or will violate any Law of any governmental or regulatory authority to which Old Natus, or any of its properties or assets are subject;

(c) violates or will violate, or conflicts with or will

conflict with, any provision of, or constitutes a default under, the Certificate of Incorporation or Bylaws of Old Natus; or

(d) (i) violates or breaches or constitutes a default (or an event which, with notice or lapse of time or both, would constitute a default) under, or give rise to a right to terminate, any mortgage, contract, agreement, deed of trust, license, lease, or other instrument, arrangement, commitment, obligation, understanding, or restriction of any kind to which Old Natus is a party and which affects the Business, or (ii) will cause, or give any person grounds to cause, to be accelerated (with notice or lapse of time or both) the maturity of, or will increase, any liability or obligation of Old Natus which violation, breach, default, liability, or obligation, individually or in the aggregate, is or would be material to the business or financial condition of the Business taken as a whole.

6.6 Financial Statements. Old Natus has heretofore delivered to ACM a pro forma balance sheet ("Balance Sheet") for Old Natus as of [December 31, 1995] ("Balance Sheet Date"), and the related statements of operations for Old Natus for the year ended June 30, 1995 and for the six month period and ending December 31, 1995. The financial statements referred to in the preceding sentence are hereinafter collectively referred to as the "Natus Financial Statements," and copies of the Natus Financial Statements are annexed hereto as Schedule 6.6. Each of the Natus Financial Statements was prepared from the books and records of Old Natus in conformity with generally accepted accounting principles (as such principles apply in the context of the financial statements of a subsidiary included within the consolidated financial statements of its parent) consistently applied and fairly present the financial condition and results of operations of Old Natus and the Business for the periods and as of the dates stated therein.

6.7 Absence of Certain Changes or Events. Since the Balance Sheet Date, Old Natus has operated the Business in the ordinary course consistent with past practice, and Old Natus has not, except as contemplated herein or as set forth in Schedule 6.7:

(a) suffered any material adverse change in the Business or any event or condition of any character, which, individually or in the aggregate, has had or might reasonably be expected to have a material adverse effect on the financial condition of the Business taken as a whole;

(b) incurred any obligations or liabilities (absolute, accrued, contingent, or otherwise) or entered into any transactions related to the Business, other than in the ordinary course of business consistent with past practices;

(c) paid, discharged, or satisfied any claims, obligations, or liabilities (absolute, accrued, contingent, or otherwise) related to the Business, except the payment, discharge, or satisfaction in the ordinary course of business and consistent with past practice of any claims, obligations, and liabilities (i) which are reflected or reserved against in the Natus Financial Statements or (ii) which were incurred in the ordinary course of business and consistent with past practice since the Balance Sheet Date;

(d) permitted or allowed any of the Business Assets to be subjected to any Encumbrances or other liabilities and obligations, except in the ordinary course of business;

(e) written off as uncollectible, or canceled or waived, any of the Receivables or any portion thereof, or any debts or claims, except in the ordinary course of business and consistent with past practice;

(f) sold, conveyed, or otherwise disposed of any Business Assets, except for fair consideration in the ordinary course of business and consistent with past practice;

(g) disposed of or permitted to lapse any item of Intangible Property, or any license, permit, or other form of authorization to use any Intangible Property; or

(h) terminated or suffered a termination of (excluding a termination in accordance with its terms) or amended, any material contract, agreement or license, relating to the Business.

6.8 Certain Tax Matters.

(a) Except as set forth in Schedule 6.8, Old Natus:

(i) has filed or will file or furnish when due in accordance with all applicable Laws all Tax returns, statements, reports, and forms (including information returns and reports) required to be filed or furnished with respect to any Pre-Contribution Tax Period (collectively, "Returns");

(ii)has correctly reflected in all material respects on the Returns (and, as to any Returns not filed as of the date hereof, will correctly reflect) the facts regarding its income and sales and status of any other information required to be shown therein;

(iii) has timely paid, withheld, or made adequate provision for all sales taxes shown as due and payable on the Returns that have been filed;

(iv)is not subject to any liens for Taxes on the Business Assets;

(b) Old Natus is not aware of any state of facts which could give rise to any claim, audit, action, suit, proceeding, or investigation with respect to any sales or employment Tax or assessment for which New Natus could be liable.

(c) Schedule 6.8(c) hereto contains a list of states and other jurisdictions to which any sales tax is currently being paid by Old Natus.

6.9 Inventory; Receivables.

(a) Substantially all items of Inventory are in good condition. As of the Contribution Date, the amount of Inventory shall be not less than $385,000.

(b) The Receivables represent bona fide obligations owed to Old Natus as to which there are no disputes, claims or offsets, except as set forth on Schedule 6.9(b).

6.10 Intellectual Property.

(a) (i) Schedule 3.1(c) contains a list of all Intangible Property owned by Old Natus and all licenses and other agreements relating to use of any such Intangible Property by third parties in connection with any business which currently competes or, to the knowledge of Old Natus, is reasonably likely to compete with the Business; and

(ii)Schedule 6.10(a)(ii) contains a list of all licenses and other agreements relating to Intangible Property which Old Natus is licensed or authorized to use by others.

(b) Except as set forth in Schedule 6.10(b),

(i) Old Natus (as of the Contribution Date), has or will have the sole and exclusive right to use the Intangible Property which is referred to in Schedules 3.1(c) and 6.10(a)(ii), and the consummation of the transactions contemplated by this Agreement and the Operating Agreement will not alter or impair any such rights and will result in New Natus having the sole and exclusive right to use all such Intangible Property to the same extent it is currently used by Old Natus;

(ii)no claims have been asserted by any person or entity for the use of any such Intangible Property or challenging or questioning the validity or effectiveness of any such license or agreement, and Old Natus has no knowledge of any valid basis for any such claim; and

(iii) to the knowledge of Old Natus, the use of such Intangible Property by Old Natus does not infringe on the rights of any person or entity, and Old Natus has not been notified of any potential claim of infringement.

6.11 Documents; Commitments.

(a) Old Natus has delivered to New Natus the following documents, each of which is true and complete:

(i) copies of all documents in Schedule 6.11(a), which is a listing of every material contract, agreement, or other commitment, written or oral, relating to the Business, to which Old Natus is a party or has succeeded to a party by assumption or assignment or in which it has a beneficial interest and excluding documents listed in any other Schedule hereto (any contract or agreement shall, for the purposes of this Agreement, be deemed material (A) if the Business taken as a whole is substantially dependent upon it, (B) if it involves a financial obligation of or benefit to the Business in excess of $10,000, (C) if the contract is not made in the ordinary course, or (D) if it constitutes a management contract or employment contract (excluding oral agreements and agreements that arise by operation of law)); and

(ii)copies of all product bulletins, technical bulletins, or other advertising or sales materials currently used in connection with the Business.

(b) Old Natus does not have (i) any outstanding sales contracts or commitments that are reasonably expected to result in any loss to the Business upon completion of performance thereof or (ii) any outstanding bids or sales or service proposals quoting prices that are not reasonably expected to result in a profit consistent with past practice.

(c) Old Natus is not restricted by agreement from carrying on the Business anywhere in the world.

6.12 No Breach.

(a) Each permit, contract, agreement, deed of trust, lease, policy, license, plan, commitment, arrangement, and understanding (whether evidenced by a written document or otherwise) referred to in this Agreement or in any Schedule hereto, under which Old Natus has any right, interest, or obligation (i) is in full force and effect, and (ii) is not subject to any threatened amendment, cancellation, or outstanding dispute.

(b) Old Natus is not in breach of any contract or agreement, and there does not exist any default or event which, with the giving of notice or the lapse of time or both, would become a breach or default, and there is no basis for any valid claim of a default in any respect, under any thereof, and Old Natus has used its best efforts to secure the consents (where such consents are necessary) of the other parties thereto to the consummation of the transactions contemplated by this Agreement and the Operating Agreement.

6.13 Consents, Permits, Etc. Except as set forth in Schedule 6.13, no consent, approval, governmental filing, authorization, or permit from any person or entity is necessary for the consummation of the transactions contemplated by this Agreement or the Operating Agreement.

6.14 Litigation. Except as set forth in Schedule 6.14, there are no suits, claims, litigation or other actions pending or, to the knowledge of Old Natus, threatened by or against, or involving Old Natus or any directors, officers, or employees thereof in their capacity as such or which question or challenge the validity of this Agreement or the Operating Agreement or any action taken or to be taken by Old Natus pursuant to this Agreement or the Operating Agreement or in connection with the transactions contemplated hereby or thereby, and to the knowledge of Old Natus, there is no valid basis for any such suits, claims, litigation or other action. It is expressly understood and agreed that New Natus is not assuming any obligations or liabilities arising from or in any way relating to the matters set forth in Schedule 6.14.

6.15 Compliance With Applicable Law; Adverse Restrictions. Except as and to the extent set forth in Schedule 6.15, the operations of Old Natus are being conducted in material compliance with (a) all applicable permits, orders, writs, injunctions, judgments, decrees, or awards of all courts and governmental and regulatory authorities, and (b) to the knowledge of Old Natus, all laws (statutory or otherwise), ordinances, rules, regulations, bylaws, and codes of all governmental and regulatory authorities, whether federal, state, or local (individually, a "Law" and collectively, "Laws"), which are applicable to the Business Assets (including, without limitation, those related to public or occupational safety, pollution and protection of the environment, and hazardous

or other waste disposal). Except as and to the extent set forth in Schedule 6.15, Old Natus has not received any written notification of any asserted present failure to comply with any Law, except for failures which in the aggregate are not and were not material to the conduct of the Business as a whole and which Old Natus has taken steps to correct or contest in good faith.

6.16 Assets Necessary to Business. As a result of the transactions effected hereby, New Natus (a) will have title to, or a valid leasehold interest in, all tangible and intangible assets and properties relating to the Business as described on the Schedules hereto, and (b) will be a party to all agreements, in each case necessary to permit New Natus to continue to carry on the Business substantially as presently conducted.

6.17 Consents, Authorizations, etc., Relating to the Business. Schedule 6.17 sets forth all consents, authorizations, approvals and permits required in connection with the Business.

6.18 Distributors, Customers and Suppliers.

(a) Schedule 6.18(a) sets forth a complete and accurate list of the distributors of the Business and their genealogy in the terms of revenue during the calendar year ended December 31, 1995, showing the approximate total revenue received by Old Natus from each such distributor during such fiscal year.

(b) Schedule 6.18(b) sets forth a list of the ten (10) largest suppliers to the Business, in terms of purchases during the calendar year ended December 31, 1995, showing the approximate total purchases by Old Natus from each supplier during such fiscal year.

(c) Except as set forth in Schedule 6.18(c), since January 1, 1996, there has not been any adverse change in the business relationship of Old Natus with any distributor or supplier which is material to the business or financial condition of the Business taken as a whole.

Article 7
REPRESENTATIONS AND WARRANTIES OF ACM

7.1 Due Authorization. ACM is a limited liability company duly formed and organized, validly existing and in good standing under the laws of the State of Arizona, and has the requisite limited liability company power and authority to own its assets and carry on its business as such business has been conducted. New Natus is a limited liability company duly formed and organized, validly existing and in good standing under the laws of the State of Arizona, and has the requisite limited liability company power and authority to own the Business Assets and carry on the Business.

7.2 Valid, Binding and Enforceable. This Agreement constitutes, and each other agreement or instrument to be executed and delivered by ACM pursuant to the terms of this Agreement, when duly executed by Old Natus, will constitute, the legal, valid and binding obligation of ACM, enforceable against ACM in accordance with its terms, except as limited by applicable bankruptcy, reorganization, arrangement, insolvency, moratorium or similar laws affecting the enforcement of creditors' rights.

7.3 No Violations. Neither the execution or delivery of this Agreement or the Operating Agreement nor the consummation of the transactions contemplated hereby or thereby:

(a) requires any filing or registration with, or consent, authorization, approval, or permit of, any governmental or regulatory authority on the part of ACM;

(b) violates or will violate (i) any order, writ, injunction, judgment, decree, or award of any court or governmental or regulatory authority or (ii) to the knowledge of ACM, violates or will violate any Law of any governmental or regulatory authority to which ACM, or any of its properties or assets are subject;

(c) violates or will violate, or conflicts with or will conflict with, any provision of, or constitutes a default under, the Articles of Organization or Operating Agreement of ACM; or

(d) violates or breaches or constitutes a default (or an event which, with notice or lapse of time or both, would constitute a default) under, or give rise to a right to terminate, any mortgage, contract, agreement, deed of trust, license, lease, or other instrument, arrangement, commitment, obligation, understanding, or restriction of any kind to which ACM is a party or by which its properties may be bound.

Article 8
SURVIVAL OF REPRESENTATIONS; INDEMNIFICATION

8.1 Survival; Indemnification.

(a) The covenants, agreements, representations, and warranties of the parties hereto contained herein or in any certificate or other writing delivered pursuant hereto or in connection herewith shall survive the Contribution Date for a period of two (2) years, except that any covenants, agreements, representations, or warranties relating to Tax matters shall extend until the expiration of the applicable statutory period of limitations (giving effect to any waiver or extension thereof). Notwithstanding the preceding sentence, any covenant, agreement, representation, or warranty in respect of which indemnity may be sought under this Section 8.1 shall survive the time at which it would otherwise terminate pursuant to such sentence, if notice of the inaccuracy or breach thereof giving rise to such indemnity shall have been given to the party against whom such indemnity may be sought, prior to such time.

(b) Each party ("Indemnitor") shall protect, defend, indemnify and hold harmless each other party ("Indemnitee") from and against any losses, damages (including, without limitation, consequential damages and penalties) and expenses (including, without limitation, reasonable counsel fees, costs and expenses incurred in investigating and defending against the assertion of such liabilities) which may be sustained, suffered or incurred by the Indemnitee and which are related to any breach by Indemnitor of its representations and warranties or obligations pursuant to this Agreement.

(c) If any actions, suit or proceeding shall be commenced, or any claim or demand shall be asserted, in respect of which the Indemnitee proposes to demand indemnification under Section 8.1 of this Agreement, the Indemnitor shall be notified to that effect with reasonable promptness and shall have the right to assume the entire control of (including the selection of counsel), subject to the right of the Indemnitee to participate (with counsel of its choice) in, the defense, compromise or settlement thereof, but the fees and expenses of such counsel shall be at the expense of the Indemnitee unless (i) the employment of such counsel by the Indemnitee has been specifically authorized by the Indemnitor, or (ii) the named parties to any such action (including any impleaded parties) include both the Indemnitee and the Indemnitor and the Indemnitee shall have been advised by its counsel that there may be one or more legal defenses available to it which are different from or additional to those available to the Indemnitor. The Indemnitee shall cooperate fully in all respects with the Indemnitor in any such defense, compromise or settlement, including, without limitation, by making available all pertinent information under its control to the Indemnitor. The Indemnitor will not compromise or settle any such action, suit, proceeding, claim or demand without the prior written consent of the Indemnitee, provided, however that in the event the approval described above is withheld, then the liabilities of the Indemnitor shall be limited to the total sum representing the amount of the proposed compromise or settlement and the amount of counsel fees accumulated at the time such approval is withheld.

8.2 Transfer Taxes. Old Natus shall pay, or cause to be paid, all Taxes or recording fees imposed on any transfers by Old Natus of intangible personal property, including without limitation Intellectual Property, applicable to the transfers of the Business Assets contemplated by this Agreement and all sales and use Taxes applicable to transfers by Old Natus of the Business Assets contemplated by this Agreement.

8.3 Tax Clearance Certificate. Old Natus shall provide to New Natus either any other tax clearance certificate required by any applicable Law as a result of the transactions effected thereby or an indemnity of New Natus for any loss incurred by reason of the failure to provide such certificates.

Article 9
RIGHT OF CO-SALE

9.1 Restricted Sales. By executing a copy of this Agreement, Mishkin agrees that he will not sell, transfer, assign or otherwise dispose of any interest in ACM or New Natus, other than to a Mishkin Affiliate, if immediately following such sale, the aggregate share of Membership Interests in New Natus held directly or indirectly, whether through ownership of Membership Interests in ACM or otherwise, by Mishkin Affiliates (the "Mishkin Interests") will be less than twenty percent of all Membership Interests outstanding (such sale a "Restricted Sale"), except in accordance with the terms of Sections 9.2 or 9.3 hereof.

9.2 Right of Co-Sale. If Mishkin shall propose to sell, exchange or otherwise dispose of any interest in ACM or New Natus through a Restricted Sale, Mishkin shall promptly deliver to Old Natus a written notice (the "Co-Sale Notice") setting forth the name and address of the proposed transferee, the percentage of Membership Interest involved and the proposed consideration for the transfer. Old Natus shall have the right and option to participate in the proposed Restricted Sale described in the Co-Sale Notice in the manner described in this Section 9.2 by delivering written notice to that effect (the "Exercise Notice") to Mishkin within ten (10) business days after delivery of the Co-Sale Notice (the "Exercise Period"). If Old Natus delivers an Exercise Notice within the Exercise Period, Mishkin shall not sell any interest in ACM or New Natus to the proposed transferee unless such proposed transferee also agrees to purchase a sufficient portion of Old Natus' Membership Interest such that the proportion of the Membership Interests so sold by Old Natus to all Mishkin Interests purchased by the proposed transferee is at least equal to the ratio which the Membership Interests held by Old Natus bear to the total of all Mishkin Interests. If Old Natus does not deliver an Exercise Notice within Exercise Period, Mishkin may transfer his interest upon the terms set forth in the Co-Sale Notice.

9.3 Certain Permitted Transfers. Notwithstanding anything to the contrary herein, this Section 9 shall have no application to any of the following:

(a) the sale of all or any portion of the Mishkin Interests through an underwritten public offering pursuant to a registration under the Securities Act of 1933; or

(b) any transfer of all or any part of the Mishkin Interests by Mishkin during his lifetime, or upon his death by will or intestacy, to or for the benefit of himself, his spouse, or other members of his family, whether by sale, exchange, gift, will or intestacy, or otherwise, in trust or otherwise; provided, however, that Section 9.1 of this Agreement shall continue to apply to such transferred Mishkin Interests.

Article 10
MISCELLANEOUS PROVISIONS

10.1 Amendment and Modification. This Agreement may be amended, modified, or supplemented only by written agreement of the parties hereto.

10.2 Waiver of Compliance; Consents. Any failure of a party to comply with any obligation, covenant, agreement, or condition herein may be waived by the other party; provided, however, that any such waiver may be made only by a written instrument signed by the party granting such waiver, but such waiver or failure to insist upon strict compliance with such obligation, covenant, agreement, or condition shall not operate as a waiver of, or estoppel with respect to, any subsequent or other failure. Whenever this Agreement requires or permits consent by or on behalf of any party hereto, such consent shall be given in writing in a manner consistent with the requirements for a waiver of compliance as set forth in this Section 10.2 with appropriate notice in accordance with Section 10.8 of this Agreement.

10.3 Successors and Assigns. This Agreement and all of the provisions hereof shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns. Nothing in this Agreement, expressed or implied, is intended or shall be construed to confer

upon any person other than the parties, any successors and permitted assigns, any rights, remedy, or claim under or by reason of this Agreement or any provisions herein contained.

10.4 Expenses. Except as otherwise contemplated by Section 8.1 hereof, whether or not the transactions contemplated by this Agreement shall be consummated, all fees and expenses (including all fees of counsel, actuaries, and accountants) incurred by any party in connection with the negotiation and execution of this Agreement and the Operating Agreement shall be borne by such party.

10.5 Further Assurances. From time to time, at the request of a party and without further consideration, the other party, at its own expense, will execute and deliver such other documents, and take such other action, as the first party may reasonably request in order to consummate more effectively the transactions contemplated hereby and to vest in New Natus good and valid title to the Business Assets.

10.6 Governing Law. This Agreement shall be governed by and construed in accordance with the Laws of the State of Arizona (without regard to its conflicts of law doctrines). Any legal action or proceeding arising out of or relating to this Agreement or any transactions contemplated hereby shall be brought in the courts of the state of Arizona or of the United States of America for the District of Arizona. Each party hereto expressly waives any claim of improper venue and any claim that such courts are an inconvenient forum, and consents to the service of process of any of the foregoing courts in any such legal action or proceeding by the mailing of copies thereof by registered or certified mail, postage prepaid, to the address set forth in Section 10.8 of this Agreement, such service to be effective 10 days after mailing.

10.7 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument and shall become a binding Agreement when one or more of the counterparts have been signed by each of the parties and delivered to the other party.

10.8 Notices. All notices and other communications hereunder shall be in writing and shall be deemed to have been duly given if delivered by hand or mailed by registered or certified mail (return receipt requested) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice):

If to Old Natus:

c/o LecTec Corporation
10701 Red Circle Drive
Minnetonka, Minnesota 55343
Attention:

If to New Natus:

c/o Great Western Development
3001 E. Camelback Road
Phoenix, Arizona 85016
Attention: President

10.9 Specific Performance. Each of the parties acknowledge that money damages would not be a sufficient remedy for any breach of this Agreement and that irreparable harm would result if this Agreement were not specifically enforced. Therefore, the rights and obligations of the parties under this Agreement shall be enforceable by a decree of specific performance issued by any court of competent jurisdiction, and appropriate injunctive relief may be applied for and granted in connection therewith. A party's right to specific performance shall be in addition to all other legal or equitable remedies available to such party.

10.10 Headings. The article and section headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

10.11 Entire Agreement. This Agreement, including the exhibits, schedules, and other documents and instruments referred to herein, together with the Operating Agreement and the Distribution Agreement, embody the entire

agreement and understanding of the parties hereto in respect of the subject matter contained herein. This Agreement supersedes all prior agreements and understandings between the parties with respect to such subject matter.

10.12 Severability. If any one or more provisions contained in this Agreement shall, for any reason, be held to be invalid, illegal, or unenforceable in any respect, such invalidity, illegality, or unenforceability shall not affect any other provision of this Agreement, but this Agreement shall be construed as if such invalid, illegal, or unenforceable provision had never been contained herein.

10.13 Inconsistency or Conflict. In the event of any inconsistency or conflict between any provision of this Agreement and any provision of the Operating Agreement, the provisions of the Operating Agreement shall govern.

10.14 Schedules. All Schedules attached hereto are hereby incorporated in and made a part as if set forth in full herein.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as of the day and year first above written.

"ACM"	"OLD NATUS"
ACM Investments, L.L.C., an Arizona limited company	Natus Corporation, a Minnesota corporation
By: Great Western Development Corporation, an Arizona corporation, Manager	/s/Kathleen A. Billings By: Kathlen A. Billings Its: President
/s/Alan R. Mishkin By: Alan R. Mishkin, President	

The undersigned, Alan R. Mishkin, acting in his individual capacity and dealing with his sole and separate property hereby guarantees the obligations of ACM Investments, L.L.C., contained in Section 2.3 of this Agreement, and agrees to be bound by the provisions of Section 9 of this Agreement.

/s/Alan R. Mishkin
Alan R. Mishkin

THE FOLLOWING CONTRIBUTION AGREEMENT SCHEDULES HAVE BEEN OMMITTED:

SCHEDULE 3.1(A)
EQUIPMENT, FURNITURE AND OTHER TANGIBLE PROPERTY

SCHEDULE 3.1(B)
RAW MATERIALS, FINISHED GOODS, WORK-IN-PROCESS

SCHEDULE 3.1(C)
PATENTS, COPYRIGHTS, INTANGIBLE PROPERTY

SCHEDULE 3.1(D)
RIGHTS, CLAIMS, CAUSES OF ACTION

SCHEDULE 3.1(E)
CONTRACTS, AGREEMENTS, LEASES, AND LICENSES

SCHEDULE 3.1(F)
RECEIVABLES

SCHEDULE 3.1(G)
PREPAID EXPENSES

SCHEDULE 3.1(H)

PAYMENTS RECEIVED FOR PRODUCTS NOT YET SHIPPED

SCHEDULE 3.1(J)
DISTRIBUTORS, CUSTOMERS AND SUPPLIERS

SCHEDULE 3.2
OUTSTANDING PURCHASE ORDERS ASSUMED

SCHEDULE 5.1(G)
OLD NATUS OPINIONS OF COUNSEL

SCHEDULE 5.2(D)
NEW NATUS OPINIONS OF COUNSEL

SCHEDULE 6.6
BALANCE SHEET

THE FOLLOWING CONTRIBUTION AGREEMENT SCHEDULES HAVE BEEN OMMITTED:

SCHEDULE 6.7
BALANCE SHEET CHANGES

SCHEDULE 6.8
TAX MATTERS

SCHEDULE 6.8(C)
SALES TAX JURISDICTIONS

SCHEDULE 6.9(B)
UNCOLLECTIBLE RECEIVABLES

SCHEDULE 6.10(A)(II)
INTANGIBLE PROPERTY LICENSES AND AGREEMENTS

SCHEDULE 6.10(B)
INTANGIBLE PROPERTY EXCEPTIONS

SCHEDULE 6.11(A)
MATERIAL AGREEMENTS

SCHEDULE 6.13
EXCEPTIONS TO CONSENTS

SCHEDULE 6.14
LITIGATION

SCHEDULE 6.15
EXCEPTIONS TO COMPLIANCE WITH LAWS

SCHEDULE 6.17
CONSENTS, AUTHORIZATIONS AND APPROVALS

SCHEDULE 6.18(A)
DISTRIBUTORS

SCHEDULE 6.18(B)
SUPPLIERS

SCHEDULE 6.18(C)
MATERIAL CHANGES

DISTRIBUTION AGREEMENT

This Distribution Agreement ("Agreement") is entered into and is effective this 12th day of March, 1996, by and among LecTec Corporation, a Minnesota corporation having its principal place of business at 10701 Red Circle Drive, Minnetonka, Minnesota ("LecTec"), Natus Corporation, a Minnesota corporation having its principal place of business at 10701 Red Circle Drive, Minnetonka, Minnesota ("Old Natus") and Natus, L.L.C., an Arizona limited liability company having its principal place of business at 3001 East Camelback Road, Suite 200, Phoenix, Arizona 85016 ("New Natus").

WHEREAS, LecTec is in the business of manufacturing Patches (as defined below) for marketing, distribution and sale to the general public; and

WHEREAS, Old Natus is in the business of distributing Patches manufactured by LecTec through means other than multi-level (network) direct sales marketing and distribution; and

WHEREAS, LecTec owns a majority of the outstanding shares of Old Natus; and

WHEREAS, New Natus is in the business of multi-level (network) direct sales marketing and distribution of products such as the Patches and desires to purchase the Patches for resale to in its multi-level (network) direct sales marketing and distribution business under Natus trademarks, utilizing Natus packaging and Natus promotional material; and

WHEREAS, LecTec has the capacity to manufacture or have manufactured New Natus's requirements of such products; and

WHEREAS LecTec is willing to sell the Patches to Old Natus for distribution to New Natus, and Old Natus is willing to distribute the Patches to New Natus, for the multi-level (network) direct sales marketing and distribution in the Exclusive Market (as defined below);

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and promises expressed herein, LecTec and New Natus agree as follows:

1. Definitions. As used herein, the following terms shall have the following meanings:

1.1 "Agreement" shall mean this Distribution Agreement, including any future written amendments, modifications, or supplements made in accordance herewith.

1.2 "Effective Date" shall have the meaning set forth in Section 3.

1.3 "Exclusive Market" shall mean the world-wide person-to-person multi-level network marketing and distribution of Patches, and specifically does not include institutional, retail, direct response infomercial or commercial spots, electronic retailing (such as HSN or QVC), marketing and distribution of Patches. It is expressly understood that this Agreement does not grant marketing and distribution rights outside the Exclusive Market.

1.4 "FDA" shall have the meaning set forth in Section 13.1(B).

1.5 "LecTec" shall mean LecTec Corporation, a Minnesota corporation.

1.6 "Old Natus" shall mean Natus Corporation, a Minnesota corporation.

1.7 "Monthly Forecast" shall have the meaning set forth in Section 9.2.

1.8 "New Natus" shall mean Natus, L.L.C., an Arizona limited

liability company.

1.9 "Patches" shall mean analgesic patches which meet the criteria set forth in the United States Food and Drug Administration monograph on external analgesic drug products for over-the-counter human use which contain the active ingredients methyl salicylate, menthol and camphor.

1.10 "Re-Commencing Party" shall have the meaning set forth in Section 19.5.

1.11 "Restricted Period" shall have the meaning set forth in Section 19.5.

1.12 "Termination Notice" shall have the meaning set forth in Section 19.4.

2. Engagement. Old Natus hereby engages New Natus, and New Natus hereby accepts such engagement, to act as the distributor for Old Natus in the Exclusive Market on the terms and conditions as set forth in this Agreement.

3. Term. The initial term of this Agreement shall begin on the date first set forth above ("Effective Date") and shall end on February 28, 2001. This Agreement shall be renewable for successive five (5) year terms thereafter provided that the parties have, prior to the end of each preceding term, reached an agreement on the price per Patch and minimum annual purchase amounts applicable to such renewal term. The parties shall, beginning not later than one year prior to the expiration of the initial term and each renewal term thereafter, negotiate in good faith with the object of reaching agreement on the price per Patch and the minimum annual purchase amount to be applied to the subsequent renewal term.

4. Limited Exclusivity. New Natus shall be the exclusive distributor of Patches in the Exclusive Market during the term of this Agreement, including any renewals hereof. New Natus shall not market Patches in or for resale in any other markets except the Exclusive Market. Neither LecTec nor Old Natus shall sell Patches to any other person or entity in or for resale in the Exclusive Market.

5. Right of First Offer for Other Analgesic Patches. Neither LecTec nor Old Natus may offer analgesic patches other than the Patches for distribution, sale or resale, whether directly or through a distributor, in the Exclusive Market unless LecTec or Old Natus, as the case may be, first offers the right to distribute such other analgesic patches to New Natus, specifying the terms of such distribution relationship, and New Natus does not accept such offer. If New Natus does not accept such offer to distribute such other analgesic patches on the terms so offered within thirty (30) days of such offer, LecTec or Old Natus, as the case may be, may offer such other analgesic patches for distribution, sale or resale in the Exclusive Market, but only through a distributor and only on such terms as are no more favorable to such distributor than the terms offered to New Natus pursuant to this Section 5.

6. Order; Minimum Purchase. New Natus shall order Patches by submitting a purchase order for the quantity of Patches desired to Old Natus. New Natus may order and purchase Patches in any quantity so long as the quantity equals or exceeds (Confidential Treatment Has Been Requested) Patches per order, and so long as the aggregate of all orders purchased exceeds the minimum annual purchase amounts as set forth on Schedule A, attached hereto and incorporated by this reference, for each year set forth in Schedule A. For the purposes of calculating the aggregate orders purchased by New Natus within the first year of this Agreement, all Patches contributed by Old Natus to New Natus pursuant to the Contribution Agreement dated March 12th, 1996, shall be deemed to have been purchased by New Natus pursuant to this Agreement.

7. Price. The purchase price to New Natus for the Patches meeting the specifications set forth in Schedule B, attached hereto and incorporated by this reference, shall be (Confidential Treatment Has Been Requested) per Patch purchased (other than those Patches deemed to have been purchased pursuant to the last sentence of Section 6). In the event that New Natus desires to purchase Patches other than Patches meeting the specifications set forth in Schedule B, New Natus and Old Natus will negotiate in good faith in an attempt to agree on a price for such Patches. In no event shall Old Natus's charges to New Natus for Patches, whether meeting the specifications set forth in Schedule B or otherwise, be in excess of LecTec's or Old Natus' usual and customary charges

for Patches of the same specifications to distributors in markets other than the Exclusive Market, and if LecTec or Old Natus offers a distributor in another market a lower price per Patch of the same specifications, New Natus shall be permitted to purchase Patches on the same terms as such other distributor.

8. Payment for Orders. New Natus shall pay to Old Natus the purchase price for Patches ordered from Old Natus within 30 days after such order is received by New Natus by payment to Old Natus.

9. Duties of New Natus.

9.1 New Natus shall devote the amount of time and effort on the part of its personnel required to promote, market and distribute the Patches.

9.2 On or before April 1, 1996, and at the beginning of each calendar month thereafter during the term hereof, New Natus shall provide Old Natus with an estimate of New Natus' requirements for Patches for the next ninety (90) days (the "Monthly Forecast").

9.3 New Natus shall comply with all United States Food and Drug Administration regulations applicable to New Natus' distribution of the Patches, including but not limited to storage, distribution and the handling of customer complaints. New Natus shall not misrepresent the nature of indications for use of the Patches and will not alter the Patches.

9.4 New Natus shall take such reasonable actions as are reasonably necessary (including cutting off supplies of Patches to or terminating distributors) to prevent any domestic or foreign entity from distributing or selling, directly or indirectly, outside the Exclusive Market any Patches sold to New Natus hereunder.

10. Duties of LecTec.

10.1 LecTec shall devote the amount of time and effort on the part of its personnel required to manufacture, produce and timely deliver all Patches ordered by New Natus. LecTec shall fill and ship all orders placed by New Natus within thirty (30) days after receipt of the corresponding purchase order provided that the quantity of Patches in such order does not exceed the estimate of New Natus' requirements for Patches contained in the Monthly Forecast. Any orders for quantities of Patches in excess of the foregoing limits shall be filled and shipped (i) to the extent of the foregoing limits, within thirty (30) days after receipt of the corresponding purchase order and, (ii) to the extent in excess of the foregoing limits, within sixty (60) days after receipt of the corresponding purchase order.

10.2 LecTec and Old Natus shall notify New Natus of any applications made or proposed (unless such notification is expressly prohibited by the third party, if any, making or proposing such application) for regulatory approval in any country or territory for the marketing or sale to the public of the Patch and any other analgesic patch for which New Natus is the distributor in the Exclusive Market, promptly upon LecTec or Old Natus obtaining knowledge of such applications. LecTec and Old Natus will, on a quarterly basis, notify New Natus of the status of any such applications made or proposed, unless such notification is expressly prohibited by the third party, if any, making or proposing such application. At the request of New Natus, LecTec and Old Natus shall cooperate with New Natus to the extent necessary to include in such applications a request for regulatory approval for the distribution and marketing within the Exclusive Market of Patches and any other analgesic patches for which New Natus is the distributor in the Exclusive Market unless such inclusion is expressly prohibited by the third party, if any, making such application. New Natus shall reimburse LecTec and Old Natus for any additional cost to LecTec and Old Natus directly associated with, and reasonably incurred as a result of, securing such additional regulatory approval for distribution and marketing in the Exclusive Market, if such additional regulatory approval is requested by New Natus.

11. Duties of Old Natus. Old Natus will timely forward any or all purchase orders and Monthly Forecasts received by it to LecTec. The failure of Old Natus to timely forward any or all purchase orders or Monthly Forecasts to LecTec shall not excuse LecTec from the timely performance of its obligations hereunder, including, without limitation, the obligation to timely fill and ship orders pursuant to Section 10 hereof.

12. Shipping. All shipping and handling costs; demurrage; storage costs; transportation insurance; sales or use taxes; and/or duties associated with any order placed by New Natus shall be paid by New Natus; provided, however, that any such costs associated with replacement shipments for defective products shipped by LecTec shall be paid by LecTec. The method and route of shipment shall be at New Natus's discretion.

13. Representations and Warranties of LecTec and Old Natus.

13.1 LecTec and Old Natus represent and warrant that:

(A) All Patches, their formulations and the methodology used in their manufacture are owned or controlled by LecTec or Old Natus and do not infringe upon any formulations or methodology not owned or controlled by LecTec or Old Natus.

(B) All Patches are produced in conformity with the United States Food and Drug Administration ("FDA") Tentative Final Monograph on External Analgesic Drug Products and are permitted to be marketed in the United States under a deferral letter from the FDA. It is expressly understood, however, that no representations or warranties are made as to the existence or likelihood of obtaining final regulatory approval for the marketing of the Patches in the United States or regulatory approval in any country outside of the United States for marketing of the Patches.

(C) Old Natus is the authorized distributor of the Patches in the Exclusive Market and has the right to enter into this Agreement relating to the distribution of the Patches in the Exclusive Market pursuant to the terms hereof.

13.2 LecTec represents and warrants that all Patches will meet LecTec's written quality and quantity specifications and are free from defects in materials and workmanship.

14. Indemnification of New Natus. LecTec and Old Natus, jointly and severally, shall indemnify, defend and hold New Natus harmless from and against any and all demands, penalties, liabilities, claims and expenses, including without limitation any attorneys' fees and costs, arising out of or relating to (1) any breach by LecTec or Old Natus of the representations and warranties contained in Section 13 hereof, or (2) any defects in the formulation, ingredients, materials, packaging, labeling or printed materials supplied by LecTec (including, but not limited to, instructions or indications for use) with respect to the Patches, provided such defect is not directly caused by negligence on the part of New Natus.

15. Indemnification of LecTec and Old Natus. New Natus shall indemnify, defend and hold LecTec and Old Natus harmless from and against any and all demands, penalties, liabilities, claims and expenses, including without limitation any attorneys' fees and costs, arising out of or relating to any claims by distributors or customers of New Natus with respect to the Patches, including, without limitation, false or deceptive advertising or claims of the Patches, except as set forth in Section 14 hereof, or the breach by New Natus of Section 9.3 hereof.

16. Insurance. LecTec and New Natus shall each secure and maintain product liability insurance in the amount of not less than $1,000,000.00 and will cause the other and Old Natus to be named as an additional insured party as its interest bears under their respective policies. LecTec and New Natus shall each provide the other and Old Natus with a certificate of insurance evidencing the requisite coverage as well as any revisions or changes subsequently made thereto.

17. Force Majeure. Neither LecTec nor Old Natus shall be responsible or liable for any loss, damage, detention or delay caused by fire, civil or military authority, insurrection, riot, or railroad, air or port embargoes.

18. Survival. The covenants and agreements of the parties contained in Sections 9.3, 14, 15 and 16 hereof shall survive the termination of this Agreement and for a period of three (3) years following the termination. Notwithstanding the foregoing, in the event that any party has given notice of a claim for indemnification within the foregoing time limit, specifying in reasonable detail the nature and, to the extent then known, the amount of the

claim, such claim shall survive until resolved.

19. Termination.

19.1 Either LecTec and Old Natus, jointly, or New Natus may terminate this Agreement for cause during its term in the event of a material default by the other party in its performance of any of the terms and conditions or covenants of this Agreement, which material default is not cured within thirty (30) days after receipt of a written notice to the defaulting party from the nondefaulting party specifying the nature of such default.

19.2 If New Natus fails to make payments in accordance with Section 8 hereof for Patches delivered to it by LecTec or Old Natus, LecTec and Old Natus may cease production and delivery of Patches against any then current and outstanding purchase order placed by New Natus with Old Natus under this Agreement until New Natus's account is brought current and such action by LecTec or Old Natus shall not constitute a breach under this Agreement.

19.3 Either LecTec and Old Natus, jointly, or New Natus may terminate this Agreement at any time if the other party, or (solely with respect to New Natus' right to terminate) Old Natus, initiates any voluntary proceeding or becomes the subject of any voluntary proceeding under any bankruptcy, reorganization, arrangement, insolvency, readjustment of debt, receivership, dissolution, or liquidation law or statute of any jurisdiction, whether now or hereafter in effect; is adjudicated insolvent or bankrupt by a decree of a court of competent jurisdiction; petitions or applies for, acquiesces in or consents to, the appointment of any receiver or trustee of such party or for all or a substantial part of the property of the party; makes an assignment for the benefit of creditors; or admits in writing its inability to pay its debts as they mature.

19.4 New Natus may terminate this Agreement upon ninety (90) days notice (the "Termination Notice") to LecTec and Old Natus if it determines it is not in its best interests to continue to distribute the Patches. If New Natus wishes to obtain Patches for sale in the Exclusive Market within the period beginning on the date of the termination of this Agreement pursuant to this Section 19.4 and ending on the earlier of (i) two (2) years from the date of termination of this Agreement pursuant to this Section 19.4, or (ii) the date upon which this Agreement would otherwise have expired pursuant to Section 3 hereof, New Natus shall offer to obtain such Patches from LecTec and Old Natus, specifying the terms upon which New Natus proposes to obtain such Patches. If LecTec and Old Natus do not accept such offer on the terms so offered within thirty (30) days of such offer, New Natus may obtain such Patches from any other supplier or suppliers, provided New Natus obtains such Patches only on such terms as are no less favorable to New Natus than those terms offered to LecTec and Old Natus. Upon the termination of this Agreement pursuant to this Section 19.4, New Natus shall purchase, upon the terms and conditions set forth herein, all unpurchased Patches manufactured prior to receipt by LecTec of the Termination Notice in reasonable reliance upon the Monthly Forecast and shall purchase (at LecTec's actual cost) all unused packaging materials ordered by LecTec prior to the Termination Notice in reasonable reliance on the Monthly Forecast.

19.5 LecTec and Old Natus, jointly, may terminate this Agreement upon ninety (90) days notice to New Natus if they determine it is not in their best interests to continue to manufacture the Patches. Under such a termination, neither LecTec nor Old Natus may supply Patches to any other distributor in the Exclusive Market or any other market during the period (the "Restricted Period") beginning on the date of the termination of this Agreement pursuant to this Section 19.5 and ending on the earlier of (i) two (2) years from the date of termination of this Agreement pursuant to this Section 19.5 or (ii) the date upon which this Agreement would otherwise have expired pursuant to Section 3 hereof. If LecTec or Old Natus wishes to supply Patches to any other distributor in the Exclusive Market or any other market during the Restricted Period, LecTec or Old Natus, as the case may be, (the "Re-Commencing Party") shall first offer to New Natus the right to distribute such Patches, specifying the terms of such distribution relationship. If New Natus does not accept such offer on the terms so offered within thirty (30) days of such offer, the Re-Commencing Party may offer such Patches for distribution, sale or resale, but only through a distributor and only on such terms as are no more favorable to such distributor than the terms offered to New Natus pursuant to this Section 19.5.

19.6 LecTec and Old Natus, jointly, may terminate this Agreement within the notice period permitted by the FDA if the United States Food and Drug Administration forbids production or distribution of the Patches.

19.7 Notwithstanding anything in any agreement between Old Natus and LecTec to the contrary, in the event of the termination of Old Natus' right to distribute the Patches for any reason, this Agreement shall not thereby be terminated. In the event of any such termination, this Agreement shall continue in full force and effect and New Natus shall continue to be the distributor of Patches in the Exclusive Market.

20. Miscellaneous.

20.1 At all times during the term of this Agreement, LecTec, Old Natus and New Natus shall be deemed to be independent parties, and neither shall have any right or authority to (a) act for the other; (b) incur, assume or create any obligation, liability or responsibility, express or impled, in the name or on behalf of the other; or (c) bind the other in any manner whatsoever. No agency, joint venture, partnership or other representative or fiduciary relationship between or among any of New Natus, LecTec and Old Natus is created by, or may be inferred from, this Agreement or the parties' performance hereunder.

20.2 Neither this Agreement nor any right or obligation hereunder shall be assigned or otherwise transferred, in whole or in part, by any party hereto (whether by operation of law or otherwise, without the prior written consent of each other party. Any assignment or transfer contrary to the terms hereof shall be null and void and of no force or effect.

20.3 This Agreement is to be governed by and construed and enforced in accordance with the laws of the State of Arizona without regard to its internal laws respecting conflicts. The venue for any dispute arising hereunder shall be Maricopa County, Arizona.

20.4 The prevailing party in any legal proceedings arising out of this Agreement shall be entitled to recover, in addition to all other legal or equitable remedies available to it, reasonable attorneys' fees and costs from the other party.

20.5 All notices, requests, demands and other communications pursuant to this Agreement shall be in writing and shall be delivered personally or sent by certified or registered mail, return receipt requested, or by telefacsimile, with receipt confirmed by telephone and hard copy mailed, to the parties at the addresses set forth below:

LecTec Corporation
10701 Red Circle Drive
Minnetonka, Minnesota 55343
Fax: (612) 933-1068
Attention:

Natus Corporation
10701 Red Circle Drive
Minnetonka, Minnesota 55343
Fax: (612) 933-1068
Attention:

Natus, L.L.C.
2777 East Camelback Road
Phoenix, Arizona 85016
Fax: (602) 954-9851
Attention: President

Any such notice, request, demand or other communication shall be deemed to have been given as of the date delivered or sent by telefacsimile, or three (3) days after deposit in the U.S. mails. A party may change the address to which notices, requests, demands and other communications hereunder are sent, by giving written notice of said change of address to the other parties in the manner above stated.

20.6 Section headings of this Agreement are solely for convenience and shall not be used in any way in the interpretation of this

Agreement or otherwise be given any legal effect.

20.7 This Agreement, including all of the schedules attached hereto, together with the Operating Agreement of New Natus dated March 12th, 1996, and the Contribution Agreement by and among Old Natus and ACM Investments, L.L.C., dated March 12th, 1996, constitute the entire understanding and agreement between the parties and supersede all previous negotiations, representations and agreements made by the parties with respect to the subject matter hereof. There are no understandings or agreements relative hereto which are not fully expressed herein; no amendments hereof shall be valid unless in writing and signed by all parties; no waiver or discharge thereof shall be valid unless in writing and signed by the party or parties whose rights are adversely affected thereby.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement in duplicate, each of which shall for all purposes be deemed an original, effective as of the Effective Date.

"LECTEC"	*"NEW NATUS"*
LECTEC CORPORATION	*Natus, L.L.C.*
/s/Thomas E. Brunelle	*/s/ Richard J. Bennetts*
President and CEO	*Richard J. Bennetts, President*

"OLD NATUS"
NATUS CORPORATION

/s/Kathleen A. Billings
President

SCHEDULE A--MINIMUM ANNUAL PURCHASE

Year	*Minimum Number of Patches*
March 1, 1996 to February 28, 1997	*(Confidential Treatment Has Been Requested)*
March 1, 1997 to February 28, 1998	*(Confidential Treatment Has Been Requested)*
March 1, 1998 to February 28, 1999	*(Confidential Treatment Has Been Requested)*
March 1, 1999 to February 29, 2000	*(Confidential Treatment Has Been Requested)*
March 1, 2000 to February 28, 2001	*(Confidential Treatment Has Been Requested)*

SCHEDULE B--PATCH SPECIFICATIONS

(Confidential Treatment Has Been Requested).

OPERATING AGREEMENT

OF

NATUS, L.L.C.,
an Arizona limited liability company,

among

ACM INVESTMENTS, L.L.C.,
an Arizona limited liability company,

NATUS CORPORATION,
a Minnesota corporation,

and

NATUS MANAGEMENT, INC.,
an Arizona corporation,

March 12, 1996

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OPERATING AGREEMENT

OF

NATUS, L.L.C.,
an Arizona limited liability company

THIS OPERATING AGREEMENT is made and entered into this 12th day of March, 1996, by and among (i) Natus Management, Inc., an Arizona corporation ("Manager"), as the Manager and a Member, and (ii) ACM Investments, L.L.C., an Arizona limited liability company ("ACM") and Natus Corporation, a Minnesota corporation ("Old Natus"), as Members.

SECTION 1
FORMATION OF THE COMPANY

1.1 Formation and Name. ACM has formed a limited liability company under the name "NATUS, L.L.C." ("Company") pursuant to the Arizona Limited Liability Company Act, Arizona Revised Statutes ss.ss. 29-601 et seq. ("LLC Act")

1.2 Place of Business. The principal place of business of the Company shall be at 2777 E. Camelback Road, Phoenix, Arizona 85016, or such other place as the Manager shall determine.

1.3 Purpose. The Company was formed (a) to acquire from Old Natus a direct selling and multi-level marketing and product distribution business formerly operated by Old Natus under the tradename of "Natus" (the "Business"), and (b) to own, operate and expand the Business to maximize the value of the Company, and may engage in any activities and perform all acts required in connection with, or incidental to, its business, it being the intention of the parties hereto to operate the Business through the Company for at least one year. Except as specifically permitted herein, the Company may not engage in any other activity or business and no Member shall have any authority to hold himself out as an agent of another Member in any other business or activity.

1.4 Term. The term of the Company commenced on the date the Articles of Organization were filed with the Arizona Corporation Commission and shall continue until December 31, 2050, unless sooner dissolved pursuant to the terms of Section 9.1.

1.5 Agent for Service of Process. The name and business address of the agent for service of process for the Company is Richard F. Ross, Esq., 40 N. Central Avenue, Suite 2700, Phoenix, Arizona 85004. The Manager may change the agent for service of process from time to time.

1.6 Manager. The Company shall be managed by a manager, who shall be Natus Management, Inc., unless changed in accordance with the terms of this Agreement. The Manager may, but need not be, a Member of the Company.

1.7 Definitions. Whenever used in this Agreement, the following terms shall have the following meanings:

"ACM." ACM Investments, L.L.C., an Arizona limited liability company.

"ADDITIONAL ASSESSMENT." As defined in Section 2.4(b).

"ADJUSTED CAPITAL ACCOUNT DEFICIT." With respect to any Member, the deficit balance, if any, in such Member's Capital Account as of the end of the relevant fiscal year, after giving effect to the following adjustments:

(a) Credit to such Capital Account any amounts which such Member is obligated to restore pursuant to any provision of this Agreement or is deemed to be obligated to restore pursuant to the penultimate sentences of Regulations ss.ss. 1.704-2(g)(1) and 1.704-2(i)(5); and

(b) Debit to such Capital Account the items described in Regulations ss.ss. 1.704-1(b)(2)(ii) (D) (4), (5), and (6).

The foregoing definition of Adjusted Capital Account Deficit is intended to

comply with the provisions of Regulations ss. 1.704-1(b)(2)(ii)(D) and shall be interpreted consistently therewith.

"AFFILIATE." A Person that:

(a) directly or indirectly controls, is controlled by or is under common control with another Person;

(b) owns or controls ten percent (10%) or more of the voting securities of such other Person;

(c) is an officer, director or partner of such other Person (or member, if such other Person is a limited liability company); or

(d) if such other Person is an officer, director, partner or member of a limited liability company, any Person for which such other Person acts in any such capacity.

For purposes of this definition, the terms "controls", "is controlled by", or "is under common control with" shall mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person or entity, whether through the ownership of voting securities, by contract, or otherwise.

"AGREEMENT." This Operating Agreement.

"BUSINESS." As defined in Section 1.3.

"BUSINESS PLAN AND BUDGET." As defined in Section 3.3(b).

"CAPITAL ACCOUNT." The Capital Account established and maintained for each Member pursuant to Section 7.6 hereof.

"CAPITAL CONTRIBUTION(S)." The amount of money and initial Gross Asset Value of any property (other than money) contributed to the Company with respect to the interest in the Company held by a Member. Any reference in this Agreement to the Capital Contribution of a Member shall include a Capital Contribution previously made by a predecessor of the Member with respect to the interest held by such Member.

"CODE." The Internal Revenue Code of 1986, as amended from time to time (or corresponding provision of succeeding law).

"COMPANY." Natus, L.L.C., an Arizona limited liability company.

"COMPANY MINIMUM GAIN." As defined in Regulations ss.ss. 1.704-2(b) (2) and 1.704-2(d).

"CONTRIBUTION AGREEMENT." The Contribution Agreement dated March 12, 1996, between Old Natus and ACM.

"DEFAULT AMOUNT." As defined in Section 2.4(c)(i).

"DEPRECIATION." For each fiscal year or other period, an amount equal to the depreciation, amortization or other cost recovery deduction allowable with respect to an asset for such year or other period, except that if the Gross Asset Value of an asset differs from its adjusted basis for federal income tax purposes at the beginning of such year or other period, Depreciation shall be an amount which bears the same ratio to such beginning Gross Asset Value as the federal income tax depreciation, amortization or other cost recovery deduction for such year or other period bears to such beginning adjusted tax basis; provided, however, that if the federal income tax depreciation, amortization, or other cost recovery deduction for such year or other period is zero, Depreciation shall be determined with reference to such beginning Gross Asset Value using any reasonable method selected by the Manager.

"DISTRIBUTION(S)." All distributions of cash or property by the Company to the Members in accordance with this Agreement.

"GROSS ASSET VALUE." With respect to any asset, the asset's adjusted basis for federal income tax purposes, except as follows:

(a) the initial Gross Asset Value of any asset contributed by

a Member to the Company shall be the gross fair market value of such asset as of the date of contribution, as determined by the contributing Member and the Manager or, in the case of Old Natus, in Section 2.1;

(b) the Gross Asset Value of all Company assets shall be adjusted to equal their respective gross fair market values, as determined by the Manager, as of the following times: (i) the acquisition of an additional interest in the Company (other than the Capital Contributions pursuant to Sections 2.2 and 2.3 of the Contribution Agreement) by any new or existing Member in exchange for more than a de minimis Capital Contribution; (ii) the distribution by the Company to a Member of more than a de minimis amount of assets of the Company as consideration for any interest in the Company; and (iii) the liquidation of the Company within the meaning of Regulations ss. 1.704-1 (b)(2)(ii)(G); provided, however, that adjustments pursuant to clauses (i) and (ii) above shall be made only if the Manager reasonably determines that such adjustments are necessary or appropriate to reflect the relative economic interests of the Members in the Company;

(c) the Gross Asset Value of any Company asset distributed to any Member shall be the gross fair market value of such asset on the date of distribution as determined by the distributee and the Manager; and

(d) the Gross Asset Values of Company assets shall be increased (or decreased) to reflect any adjustment to the adjusted basis of such assets pursuant to Code ss. 734(b) or Code ss. 743(b), but only to the extent that such adjustments are taken into account in determining Capital Accounts pursuant to Regulations ss. 1.704-1(b)(2)(iv)(M) and Section 7.3(g) hereof; provided, however that Gross Asset Values shall not be adjusted pursuant to this subsection (d) to the extent the Manager determines that an adjustment pursuant to subsection (b) hereof is necessary or appropriate in connection with a transaction that would otherwise result in an adjustment pursuant to this subsection (d).

If the Gross Asset Value of an asset has been determined or adjusted pursuant to (a), (b), or (d) above, such Gross Asset Value shall thereafter be adjusted by the Depreciation taken into account with respect to such asset for the purposes of computing Profits and Losses.

"LLC ACT." The Arizona Limited Liability Company Act, Arizona Revised Statutes ss.ss. 29-601 et seq., as amended.

"MANAGER." Natus Management, Inc., an Arizona corporation.

"MAXIMUM CONTRIBUTION." As defined in Section 2.2.

"MEMBER." Each of the Members named in this Agreement and any other Person that becomes a Member pursuant to this Agreement.

"MEMBER NONRECOURSE DEBT." As defined in Regulations ss. 1.704-2(b)(4).

"MEMBER NONRECOURSE DEBT MINIMUM GAIN." An amount which, with respect to each Member Nonrecourse Debt, is equal to the Company Minimum Gain that would result if such Member Nonrecourse Debt were treated as a Nonrecourse Liability determined in accordance with Regulations ss. 1.704-2(i)(3).

"MEMBER NONRECOURSE DEDUCTIONS." As defined in Regulations ss.ss. 1.704-2(i)(1) and 1.704-2(i)(2).

"MEMBERSHIP INTEREST." The interest of a Member in the Profits, Losses and Distributions (except as otherwise provided in this Agreement) of the Company.

"NONRECOURSE DEDUCTION." As defined in Regulations ss. 1.704-2(b)(1).

"NONRECOURSE LIABILITY." As defined in Regulations ss. 1.704-2(b)(3).

"OFFICER." With respect to the Company, any Person appointed an officer of the Company pursuant to Section 4.

"OLD NATUS." Natus Corporation, a Minnesota corporation.

"PERSON." An individual, firm, partnership, corporation, limited liability company, estate, trust or other entity.

"PROFITS AND LOSSES." With respect to any fiscal year or other period, an amount equal to the Company's taxable income or loss for such year or period, determined in accordance with Code ss. 703(a) (for this purpose, all items of income, gain, loss or deductions required to be stated separately pursuant to Code ss. 703(a)(1) shall be included in taxable income or loss), with the following adjustments:

(a) any income of the Company that is exempt from federal income tax and not otherwise taken into account in computing Profits or Losses pursuant to this definition shall be added to such taxable income or loss;

(b) any expenditures of the Company described in Code ss. 705(a)(2)(B) or treated as Code ss. 705(a)(2)(B) expenditures pursuant to Regulations ss. 1.704-1(b)(2)(iv)(I), and not otherwise taken into account in computing Profits or Losses hereunder shall be subtracted from such taxable income or loss;

(c) if the Gross Asset Value of any Company asset is adjusted pursuant to subsections (b) or (c) of the definition of Gross Asset Value herein, the amount of such adjustment shall be taken into account as gain or loss from the disposition of such asset for purposes of computing Profits or Losses;

(d) gain or loss resulting from any disposition of Company property with respect to which gain or loss, if any, would be recognized for federal income tax purposes shall be computed by reference to the Gross Asset Value of the Company assets disposed of, notwithstanding that the adjusted tax basis of such Company assets may differ from its Gross Asset Value;

(e) in lieu of the depreciation, amortization and other cost recovery deductions taken into account in computing such taxable income or loss, there shall be taken into account Depreciation for such fiscal year or other period, computed in accordance with the definition set forth herein;

(f) to the extent an adjustment to the adjusted tax basis of any Company asset pursuant to Code ss. 734(b) or Code ss. 743(b) is required pursuant to Regulations ss. 1.704-1(b)(2)(iv)(M)(4) to be taken into account in determining Capital Accounts as a result of a distribution other than in complete liquidation of a Member's Membership Interest in the Company, the amount of such adjustment shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases the basis of the asset) from the disposition of the asset and shall be taken into account for purposes of computing Profits or Losses; and

(g) notwithstanding any other provision of this definition, any item which is specially allocated pursuant to Sections 7.3 or 7.4 of this Agreement shall not be taken into account in computing Profits and Losses.

The amounts of the items of Company income, gain, loss or deduction available to be specially allocated pursuant to Sections 7.3 or 7.4 hereof shall be determined by applying rules analogous to those set forth in this definition of Profits and Losses.

"REGULATIONS." The temporary and final Treasury Regulations promulgated under the Code, as such regulations may be amended from time to time (including corresponding provisions of succeeding regulations).

"REGULATORY ALLOCATIONS." As defined in Section 7.4.

"TRANSFER." To sell, assign, transfer, give, donate, pledge, deposit, alienate, bequeath, devise or otherwise dispose of or encumber to any Person other than the Company.

SECTION 2
CAPITAL CONTRIBUTIONS; MEMBERSHIP INTERESTS

2.1 Capital Contribution of Old Natus. Old Natus shall contribute, as a contribution to the capital of the Company, assets of the Business pursuant to the terms of the Contribution Agreement. The Gross Asset Value of Old Natus's Capital Contribution (as reflected on the Balance Sheet (as such term is defined in the Contribution Agreement)) is _____ Dollars ($_____),

which amount shall be adjusted to reflect changes in the components of the Balance Sheet as of the Contribution Date (as such term is defined in the Contribution Agreement) made in the ordinary course of business. As set forth in the Contribution Agreement, the Company shall not assume, nor acquire any assets subject to, any liabilities, of Old Natus, whether or not related to the Business, other than as specifically set forth in the Contribution Agreement.

2.2 Capital Contribution of ACM. ACM shall contribute an amount not to exceed the sum of One Million and No/100ths Dollars ($1,000,000.00) in cash to the capital of the Company ("Maximum Contribution") on an "as and if needed basis," provided, however, that at such time as the Manager has prepared the Business Plan and Budget pursuant to Section 3.3(b) of this Agreement, ACM shall contribute such amounts (up to an aggregate of the Maximum Contribution) as required from time to time by the Business Plan and Budget (provided the Company achieves the anticipated results set forth in the Business Plan and Budget). In no event shall ACM be required to contribute more than the Maximum Contribution to the Company, nor shall ACM be required to contribute capital to the Company to fund, directly or indirectly, distributions to the Members. Notwithstanding the foregoing, (i) if Old Natus shall become in material default under this Agreement, the Distribution Agreement or the Contribution Agreement, and such default is not cured within sixty (60) after written notice thereof to Old Natus of the default, or (ii) four (4) years after the date of this Agreement, the obligation of ACM to continue to contribute cash to the capital of the Company (up to the Maximum Contribution) shall terminate and expire and be of no further force and effect.

2.3 Capital Contribution of Manager. The Manager shall not be required to contribute any amounts to the capital of the Company.

2.4 Additional Capital Contributions. 1 Contributions.

(a) Discretionary. The Members may make additional Capital Contributions from time to time in such amounts and proportions as are unanimously agreed.

(b) Required. The Manager may make a capital call on ACM from time to time in accordance with Section 2.2 of this Agreement if and to the extent that the Company requires additional capital; provided, however, that if the Manager has prepared the Business Plan and Budget required pursuant to Section 3.3(b) of this Agreement, such additional capital calls may be made by the Manager only in accordance with such Business Plan and Budget, and only if the Company achieves the anticipated results set forth in the Business Plan and Budget ("Additional Assessment"). The Manager shall provide written notice of the requirement for such Additional Assessments to ACM at least thirty (30) days prior to the date on which such Additional Assessments are required to be made. If ACM fails to make payment when due of its share of any Additional Assessments, ACM shall be in default, and the Company, the Manager and the other Members may exercise any and all remedies to which they may be entitled.

(c) Remedies. In addition to any remedies otherwise available at law or in equity, and in the alternative, the Manager in its sole discretion may, in the event of a default by ACM in paying any Additional Assessment:

> *(i) suspend all rights (including the right to vote) and benefits attributable to ACM's Membership Interests and apply all Distributions otherwise owing to ACM against the Additional Assessments that ACM failed to make plus any expenses of the Company resulting from such failure ("Default Amount"), until the amount of such Distributions, together with any other payments made by ACM, have cured such default by paying to the Company the Default Amount; or*
>
> *(ii) pay the Default Amount, and receive a Membership Interest in the Company in proportion to the ratio the Default Amount bears to the Capital Contributions paid by all of the Members, and reduce the Membership Interest of ACM by a corresponding amount.*

(d) Reasonableness of Remedies. ACM acknowledges and agrees that its failure to make a payment owing by reason of any Additional Assessments will subject the Company to substantial damage. ACM acknowledges and agrees that

it is extremely difficult and impractical to ascertain the extent of such damages to the Company, the other Members and the Manager, and ACM acknowledges and agrees that the remedies set forth in this Section 2.4 are reasonable and do not constitute invalid penalty provisions.

2.5 Temporary Loans. The Manager may cause the Company to borrow funds (i) in the ordinary course of business from third parties, (ii) if ACM has made the Maximum Contribution (or the obligation of ACM to make the Maximum Contribution has expired pursuant to Section 2.2 of this Agreement) and the Capital Contributions, including the Maximum Contribution, operating income and other Company funds are insufficient to finance Company activities, or (iii), after the twelve (12) month period commencing on the date of this Agreement, out of the ordinary course of business from any party that is not an Affiliate of a Member. Any such loans shall be on such terms and conditions as the Manager shall determine, which terms and conditions shall be substantially the same as those upon which the Company could obtain such a loan from an unrelated third party financial institution doing business in Arizona. The inability of the Company to obtain such a loan on more favorable terms from such an unrelated third party financial institution shall be conclusive evidence that such terms and conditions satisfy the requirements hereof.

2.6 Membership Interests. The respective Membership Interests of the Members shall be as follows:

Manager	*Membership Interest*
ACM	*84.15%*
Old Natus	*14.85%*
Manager	*1.00%*
	100.00%

2.7 Investment of Proceeds and Reserves. The cash reserves of the Company may be temporarily invested in short-term highly liquid investments where there is appropriate safety of principal.

2.8 Priority and Return of Capital. Except as expressly set forth in this Agreement, no Member shall have priority over any other Member, either as to the return of Capital Contributions or as to Profits, Losses or Distributions; provided, however, that this Section shall not apply to advances or loans which a Member has made to the Company. No Member shall receive any interest, salary or other return with respect to his Capital Contributions, Capital Account or for services rendered on behalf of the Company or otherwise in his capacity as a Member, except with respect to (a) such Member's service as an Officer of the Company, or (b) loans made to the Company, or except as otherwise specifically set forth in this Agreement.

2.9 Payments of Individual Obligations. The Company's credit and assets shall be used solely for the benefit of the Company, and no asset of the Company shall be transferred or encumbered for or in payment of any individual obligation of a Member.

2.10 Limitation of Liability. Each Member's liability for the debts and obligations of the Company shall be limited as set forth in the Act.

2.11 Return of Certain Capital Contributions. If, prior to the earlier to occur of the first (1st) anniversary of the date of this Operating Agreement or the contribution of at least the Maximum Contribution by ACM, the Company is dissolved, sells all or substantially all of its assets, or ceases operations, all rights to use the registered trademark "NatusPatch" and all rights acquired from Old Natus to distribute analgesic patches shall be returned to Old Natus.

SECTION 3
THE MANAGER

3.1 Management. The Manager shall have the exclusive right to manage the affairs of the Company and shall have all rights, powers and authority afforded to the Manager of a Company under the LLC Act. Without limiting the generality of the foregoing, the Manager shall have full power and authority to do the following:

(a) to hold, operate, maintain, otherwise deal with the assets of the Company;

(b) to engage, on behalf of the Company all employees, agents, architects, engineers, contractors, attorneys, accountants, consultants or any other Persons (including Affiliates of the Manager) as the Manager, in its sole discretion, deems appropriate for the performance of legal and accounting services or otherwise in connection with the conduct, operation and management of the Company's business and affairs, all on such terms and for such compensation as the Manager, in its sole discretion, deems proper; provided, however, that if the Manager engages Affiliates of the Manager, such engagement shall be on terms no less favorable to the Company than the terms on which such services would be available from non-affiliated third-parties;

(c) to prosecute, defend, settle or compromise, at the Company's expense, any suits, actions or claims at law or in equity to which the Company is a party or by which it is affected as may be necessary or proper in the Manager's sole discretion, to enforce or protect the Company's interests, and to satisfy out of Company funds any judgment, decree or decision of any court, board, agency or authority having jurisdiction or any settlement of any suit, action or claim prior to judgment or final decision thereon;

(d) to pay the expenses of the Company from the funds of the Company; provided that all of the Company's expenses shall, to the extent feasible, be billed directly to and paid by the Company;

(e) to dissolve and liquidate the Company;

(f) to make loans to the Company and charge a reasonable rate of interest on such loans;

(g) to admit as Members any Persons to whom Transfers of Membership Interests are properly made pursuant to Section 8 of this Agreement;

(h) to vote at any election or meeting of any corporation in person, or by proxy, and to appoint agents to do so in its place and stead;

(i) to file, on behalf of the Company, all required local, state and federal tax returns relating to the Company or its assets and properties, and to make or determine not to make any and all elections with respect thereto, subject to the provisions of Section 7 of this Agreement;

(j) to invest and reinvest the funds of the Company and to establish bank, money market and other accounts for the deposit of the Company's funds and permit withdrawals therefrom upon such signatures as the Manager designates:

(k) to obtain casualty and liability insurance on behalf of and for the protection of the Company and the Members;

(l) to execute and deliver any and all instruments and documents, and to do any and all other things necessary or appropriate, in the Manager's sole discretion, for the accomplishment of the business and purposes of the Company or necessary or incidental to the protection and benefit of the Company;

(m) to establish and maintain a working capital reserve for operating expenses, capital expenditures, normal repairs, replacements, contingencies, and other anticipated costs relating to the assets of the Company by retaining a percentage of revenues of the Company as determined from time to time by the Manager to be reasonable under the then-existing circumstances;

(n) to appoint Officers pursuant to Section 4.2 and to delegate any of the Manager's rights, powers and authority to any one or more of such Officers;

(o) to amend this Agreement, provided that such amendment is of an inconsequential nature and does not adversely affect the Members in any material respect, or is necessary or desirable to comply with any applicable law or governmental regulation or is required or contemplated by this Agreement.

3.2 Fees and Compensation to the Manager and Its Affiliates. The Manager shall not be entitled to receive any compensation for its services to the Company in its capacity as a Manager, but shall be entitled to reimbursement for its expenses incurred in connection with the Company.

3.3 Duties and Obligations of the Manager.ns of the Manager.

(a) The Manager shall take action which may be necessary or appropriate (i) for the continuation of the Company's valid existence as a limited liability company under the laws of the state of Arizona; (ii) for the qualification of the Company to do business in any jurisdiction in which such qualification is necessary to conduct the Company's business; and (iii) for the acquisition, development, maintenance, preservation and operation of all of the Company's business in accordance with the provisions of this Agreement and applicable laws and regulations.

(b) Within six (6) months after the date of this Agreement with respect to the first year of operations, and thereafter within sixty (60) days after the end of the preceding fiscal year, for all subsequent years of operation, the Manager shall develop and prepare a business plan and operating budget (the "Business Plan and Budget") for the fiscal year, consistent with the purposes of the Company as set forth in Section 1.3 hereof, which Business Plan and Budget shall set forth the anticipated capital needs of the Company and the anticipated results of business of the Company. The Manager shall promptly deliver a copy of each year's Business Plan and Budget, when prepared, and any amendments thereto, to each Member.

(c) The Manager shall devote to the Company such time as may be necessary for the proper performance of its duties hereunder, but shall not be required to devote its full time to the performance of such duties.

(d) The Manager shall be under a fiduciary duty to conduct the affairs of the Company in the best interests of the Company and of the Members, including the safekeeping and use of all Company funds and assets for the exclusive benefit of the Company. Neither the Manager nor any Affiliate of the Manager shall enter into any transaction with the Company which may significantly benefit the Manager or any such Affiliate in its independent capacity unless the transaction is expressly permitted hereunder or is entered into principally for the benefit of the Company in the ordinary course of the Company's business.

3.4 Confirmation of Authority. Any documents to be executed on behalf of the Company, including, but not limited to, agreements, leases, deeds, mortgages, deeds of trust, notes, bonds, assignments, stock powers and other forms of contracts, and all amendments, modifications or rescissions of the same, shall be binding upon and considered as authorized for the Company when signed on its behalf by the Manager, by any Officer so authorized pursuant to this Agreement or by such other Person as the Manager shall specify in writing.

3.5 Liability and Indemnification of the Manager. The Manager, its officers, directors, shareholders and agents, shall not be liable, responsible or accountable in damages or otherwise to the Company or to any of the Members for any act or omission performed or omitted by it, its officers, directors, shareholders or agents in good faith pursuant to the authority granted to the Manager by this Agreement in a manner reasonably believed by the Manager, such officers, directors or agents, to be within the scope of the authority granted to Manager by this Agreement and in or not opposed to the best interest of the Company or the Members; provided, however, that neither the Manager, its officers, directors, nor its agents, shall be relieved of liability in respect of any claim, issue or matter as to which the Manager, its officers, directors or agents shall have been adjudged to be liable for gross negligence or willful misconduct in the performance of its fiduciary duty to the Company or to the Members; and, subject to such limitation in the case of any such judgment of liability, the Company shall indemnify, defend and hold the Manager, its officers, directors, shareholders and agents harmless against any loss or damage incurred by them including but not limited to any loss or damage resulting solely by reason of serving as Manager or as an officer, director, shareholder or agent thereof, and against expenses (including attorneys' fees and costs) actually and reasonably incurred by Manager, its officers, directors, shareholders and agents in connection with the defense or settlement of any threatened, pending or completed action or suit by any Member in connection therewith. The satisfaction of any indemnification and any saving harmless shall be from and limited to Company assets, and no Member shall have any personal liability on account thereof except as otherwise set forth in this Agreement.

3.6 Withdrawal of the Manager. The Manager shall not resign as Manager without the approval of the Members holding at least a majority of the

Membership Interests. Upon a two-thirds vote of all Members, the Members may remove the Manager as Manager and designate another person or entity as Manager.

SECTION 4
OFFICERS OF THE COMPANY

4.1 Required Officers. The Officers of the Company shall be a Chief Executive Officer, a President, and one or more Vice-Presidents. The Manager may also designate such other offices as the Manager, in its sole discretion, deems proper or appropriate, and the persons filing such offices shall be deemed "Officers" for the purposes of this Agreement, and they shall hold their offices for such terms, exercise such powers and perform such duties as shall be determined from time to time by the Manager.

4.2 Appointment of Officers. The Officers of the Company shall be selected by the Manager and shall be natural persons. Any number of offices may be held by the same person, unless this Agreement provides otherwise. The initial Officers of the Company shall be as follows:

Officer	*Office*
Alan R. Mishkin	*Chief Executive Officer*
Richard J. Bennetts	*President*
Kathleen Billings	*Vice President--Marketing and Products Development*
Ryan Wuerch	*Vice President--Sales*
Stanley Lumpp	*Vice President--Distribution*

4.3 Salaries. The salaries of the Officers shall be fixed from time to time by the Manager, and no Officer shall be prevented from receiving such salary by reason of the fact that he is also an Affiliate of a Member or the Manager.

4.4 Term of Office. The Officers shall hold office until their successors are chosen and qualified. Any Officer may be removed at any time by the Manager. Any vacancy occurring in any office because of death, resignation, removal, disqualification or otherwise shall be filled by the Manager.

4.5 Chief Executive Officer. The Chief Executive Officer, if one shall have been appointed and be serving, shall preside at all meetings of the Members. The Chief Executive Officer shall act as directing head of the Company and shall be responsible for the development of the overall business strategies and goals of the Company, in a manner consistent with the purpose of the Company set forth in Section 1.3 and the decisions of the Manager.

4.6 President. If a Chief Executive Officer shall not have been appointed or, having been appointed, shall not be serving or be absent, the President shall preside at all meetings of the Members. The President shall possess the power and may perform the duties of the Chief Executive Officer in his absence or disability and shall perform such other duties as may be prescribed from time to time by the Manager or the Chief Executive Officer. He shall have general and active management of the day to day business and affairs of the Company and shall see that all decisions of the Manager and the Chief Executive Officer are carried into effect. The President shall sign, unless he or the Manager designates in writing someone to sign on his or her behalf, all deeds and conveyances, all contracts and agreements, and all other instruments requiring execution on behalf of the Company.

4.7 Vice Presidents. There shall be as many Vice Presidents as shall be determined by the Manager from time to time, and they shall perform such duties as from time to time may be assigned to them. Any one of the Vice Presidents, as authorized by the Manager or Chief Executive Officer, shall have all the powers and perform all the duties of the President in case of the temporary absence of the President, or in the case of his or her temporary inability to act. In case of the permanent absence or inability of the President to act, the office shall be declared vacant by the Manager and a successor shall be chosen by the Manager.

4.8 Liability and Indemnification of the Officers. No Officer shall be liable, responsible or accountable in damages or otherwise to the Company or to any of the Members for any act or omission performed or omitted by him in good faith pursuant to the authority granted to him by this Agreement in a manner reasonably believed by him to be within the scope of the authority granted to him by this Agreement and in or not opposed to the best interest of the Company

or the Members; provided, however, that no Officer shall be relieved of liability in respect of any claim, issue or matter as to which such Officer shall have been adjudged to be liable for gross negligence or willful misconduct in the performance of his fiduciary duty to the Company or to the Members; and, subject to such limitation in the case of any such judgment of liability, the Company shall indemnify, defend and hold each Officer harmless against any loss or damage incurred by him including but not limited to any loss or damage resulting solely by reason of serving as an Officer and against expenses (including attorneys' fees and costs) actually and reasonably incurred by him in connection with the defense or settlement of any threatened, pending or completed action or suit by any Member in connection therewith. The satisfaction of any indemnification and any saving harmless shall be from and limited to Company assets, and no Member shall have any personal liability on account thereof except as otherwise set forth in this Agreement.

SECTION 5
THE MEMBERS

5.1 Members' Right to Vote. Except as set forth in Section 3.6 hereof, the Members shall not have the right to vote on any matters with respect to the business or affairs of the Company except the following matters, as to which the vote of Members holding a majority-in-interest of the Membership Interests shall be obtained before the Manager undertakes any such action:

(a) any change in the purpose of the Company;

(b) any amendment to the Operating Agreement that reduces any Member's Membership Interest; or

(c) any sale or lease of substantially all of the assets of the Company to the Manager or any Affiliate thereof.

5.2 Meetings. The Manager shall call a meeting of the Members at least once each year, on such date and at such time as the Manager deems desirable. Special meetings of the Members may be called by the Manager from time to time to obtain the vote of the Members on the matters set forth in Sections 3.6 or 5.1, or for any other purpose or purposes. Each Member shall pay its own expenses incurred in connection with any meeting of the Members of the Company.

5.3 Place of Meetings. The Manager may designate any place, either within or outside the State of Arizona, as the place of meeting for any meeting of the Members. If no designation is made, or if a special meeting be otherwise called, the place of meeting shall be held at the principal place of business of the Company, as set forth in Section 1.2.

5.4 Notice of Meetings. Written notice stating the place, day and hour of the meeting and the purpose or purposes for which the meeting is called shall be delivered not less than three (3) nor more than fifty (50) days before the date of the meeting, either personally or by mail, by or at the direction of the Manager, to each Member entitled to vote at such meeting, unless notice is waived in writing by each Member.

5.5 Proxies. At all meetings of the Members, a Member may vote in person or by proxy executed in writing by the Member or by a duly authorized attorney-in-fact. Such proxy shall be filed with the Company before or at the time of the meeting. No proxy shall be valid after eleven months from the date of its execution, unless otherwise provided in the proxy.

5.6 Action by Members Without a Meeting. Any action required or permitted to be taken at a meeting of Members may be taken without a meeting if the action is evidenced by one or more written consents describing the action taken, signed by Members holding the proportion of Membership Interests as is required by this Agreement to take such action, and delivered to the Company for inclusion in the minutes or for filing with the Company records. Prior to the Members taking an action under this Section on any matter identified in Sections 5.1(a) through 5.1(c), the Manager shall notify all Members of the proposed action in writing. An action taken under this Section is effective when the required number of Members have signed the consent, unless the consent specifies a different effective date. The Manager shall notify all Members of any action taken under this Section.

5.7 Other Activities of the Members. The Members and their Affiliates may engage in other businesses and activities of every nature and description,

independently and with others, provided, however, that except as set forth in this Section 5.7, no Member nor its Affiliates shall engage in, own, directly or indirectly or be employed (whether as an employee or consultant) by, any entity engaged in the multi-level (direct sales) marketing business in any of its current aspects, and neither the Company nor any Member shall by reason of this Agreement have any rights in any such venture or in the income or profits derived therefrom. The Members acknowledge that Alan R. Mishkin, an Affiliate of ACM and Manager, indirectly owns an interest in Red Rock Collections, Inc., a corporation that does or may engage in the business of multi-level (direct sales) marketing and product distribution and acknowledge that such ownership interest shall not be deemed to be in violation of this Section 5.7.

5.8 Indemnification of the Members. The Company shall protect, defend, indemnify and hold harmless each Member from and against any losses, damages (including, without limitation, consequential damages and penalties) and expenses (including, without limitation, reasonable counsel fees, costs and expenses incurred in investigating and defending against the assertion of such liabilities) which may be sustained, suffered or incurred by such Member in connection any claims asserted by third-parties against such Member arising from the operation of the Business by the Company.

SECTION 6
DISTRIBUTIONS

6.1 Amount and Time of Distribution. The portion, if any, of the Company's cash funds and other property, after payment of expenses and the making of all other required expenditures shall be distributed:

(a) on or before April 15, June 15 and September 15 of each fiscal year of the Company and January 15 and April 15 of the year following such fiscal year, an amount of cash with respect to each Member's income tax liability attributable to allocations of Profits to each Member for such fiscal year and prior fiscal years of the Company. The amount of each such distribution shall be equal to (i) 35% of the excess of (A) the cumulative Profits allocated to the Member pursuant to this Agreement for the fiscal year and all prior fiscal years of the Company (including a reasonable estimate of the Member's allocable share of Profits for the fiscal year as of the end of the month preceding the distribution) over (B) cumulative Losses allocated to the Member pursuant to this Agreement for all prior fiscal years of the Company minus (ii) the sum of all prior distributions to such Member; and

(b) to the Members from time to time as the Manager deems proper.

6.2 General Rule for Distributions. Except as otherwise provided in this Agreement, all Distributions (other than those pursuant to Section 6.1(a)) shall be made to the Members in accordance with their respective Membership Interests. Upon liquidation, or in the event of a sale of substantially all of the assets of the Company in a single transaction, regardless of whether such sale of the Company causes a dissolution pursuant to Section 9.1 of this Agreement, liquidation or sales proceeds, as the case may be, shall be distributed to the Members in accordance with Section 9.3.

6.3 No Distribution upon Withdrawal. No withdrawing Member shall be entitled to receive any Distribution or the value of such Member's Membership Interest as the result of such withdrawal prior to the liquidation of the Company.

SECTION 7
ALLOCATION OF PROFITS AND LOSSES

7.1 Allocation of Profits. After taking into account the special allocations provided in Sections 7.3 and 7.4, Profits, if any, of the Company shall be allocated as follows:

(a) first, 100% to the Members until the aggregate Profits allocated to the Members pursuant to this Section 7.1(a) for such fiscal year and all previous years is equal to the aggregate Losses allocated to the Members pursuant to the last sentence of Section 7.2 of this Agreement for all previous years; and

(b) second, the balance, if any, shall be allocated to the Members in accordance with their respective Membership Interests.

7.2 Allocation of Losses. After taking into account the special allocations provided in Sections 7.3 and 7.4, Losses, if any, of the Company shall be allocated to the Members in accordance with their respective Membership Interests; provided, however, that the Losses allocated pursuant to this Section 7.2 to any Member shall not exceed the maximum amount of Losses that can be so allocated without causing any Member to have an Adjusted Capital Account Deficit at the end of any fiscal year. If an allocation of Losses pursuant to this Section 7.2 would cause one, but not all, of the Members to have an Adjusted Capital Account Deficit as a result of such allocation, the limitation set forth in this Section 7.2 shall be applied on a Member by Member basis so as to allocate the maximum permissible Losses to each Member under Regulations ss. 1.704-1(b)(2)(ii)(D).

7.3 Special Allocations. The following special allocations shall be made in the following order:

(a) Except as otherwise provided in Regulations ss. 1.704-2(f), notwithstanding any other provision of this Section 7, if there is a net decrease in Company Minimum Gain during any fiscal year, each Member shall be specially allocated items of Company income and gain for such fiscal year (and, if necessary, subsequent fiscal years) in an amount equal to such Member's share of the net decrease in Company Minimum Gain, determined in accordance with Regulations ss. 1.704-2(g). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant thereto. The items so to be allocated shall be determined in accordance with Regulations ss.ss. 1.704-2(f)(6) and 1.704-2(j)(2). This Section 7.3(a) is intended to comply with the minimum gain chargeback requirement in Regulations ss. 1.704-2(f) and shall be interpreted consistently therewith.

(b) Except as otherwise provided in Regulations ss. 1.704-2(i)(4), notwithstanding any other provision of this Section 7, if there is a net decrease in Member Nonrecourse Debt Minimum Gain attributable to a Member Nonrecourse Debt during any fiscal year, each Member who has a share of the Member Nonrecourse Debt Minimum Gain attributable to such Member Nonrecourse Debt, determined in accordance with Regulations ss. 1.704-2(i)(5), shall be specially allocated items of Company income and gain for such year (and, if necessary, subsequent fiscal years) in an amount equal to such Member's share of the net decrease in Member Nonrecourse Debt Minimum Gain attributable to such Member Nonrecourse Debt, determined in accordance with Regulations ss. 1.704-2(i)(4). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant thereto. The items to be so allocated shall be determined in accordance with Regulations ss.ss. 1.704-2(i)(4) and 1.704-2(j)(2). This Section 7.3(b) is intended to comply with the minimum gain chargeback requirement in Regulations ss. 1.704-2(i)(4) and shall be interpreted consistently therewith.

(c) If any Member unexpectedly receives any adjustments, allocations or distributions described in Regulation ss.ss. 1.704-1(b)(2)(ii)(D) (4), (5), or (6), items of Company income and gain shall be specially allocated to such Member in an amount and a manner sufficient to eliminate, to the extent required by the Regulations, the Adjusted Capital Account Deficit of such Member as quickly as possible; provided that an allocation pursuant to this Section 7.3(c) shall be made only if and to the extent that such Member would have an Adjusted Capital Account Deficit after all other allocations provided for in this Section 7 have been tentatively made as if this Section 7.3(c) were not in this Agreement.

(d) If any Member has a deficit Capital Account at the end of any fiscal year which is in excess of the sum of (i) the amount such Member is obligated to restore pursuant to any provision of this Agreement, and (ii) the amount such Member is deemed to be obligated to restore pursuant to the penultimate sentences of Regulations ss.ss. 1.704-2(g)(1) and 1.704-2(i)(5), each such Member shall be specially allocated items of Company income and gain in the amount of such excess as quickly as possible; provided that an allocation pursuant to this Section 7.3(d) shall be made only if and to the extent that such Member would have a deficit Capital Account in excess of such sum after all other allocations provided in this Section 7.3 have been made as if Section 7.3(c) hereof and this Section 7.3(d) were not in this Agreement.

(e) Nonrecourse Deductions for any fiscal year shall be

specially allocated to the Members in accordance with their Membership Interests.

(f) Any Member Nonrecourse Deductions for any fiscal year shall be specially allocated to the Member who bears the economic risk of loss with respect to the Member Nonrecourse Debt to which such Member Nonrecourse Deductions are attributable in accordance with Regulations ss. 1.704-2(i)(1).

(g) To the extent an adjustment to the adjusted tax basis of any Company asset pursuant to Code ss. 734 (b) or Code ss. 743 (b) is required to be taken into account pursuant to Regulations ss.ss. 1.704-1 (b) (2)(iv)(M)(2) or 1.704-1 (b) (2)(iv)(M)(4) in determining Capital Accounts as the result of a distribution to a Member in complete liquidation of his interest in the Company, the amount of such adjustment to Capital Accounts shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases such basis) and such gain or loss shall be specially allocated to the Members in accordance with their interests in the Company if Regulations ss. 1.704-1 (b) (2)(iv)(M)(2) applies, or to the Member to whom such distribution was made if Regulations ss. 1.704-1(b)(iv)(M)(4) applies.

7.4 Curative Allocations. The allocations set forth in Section 7.3 hereof ("Regulatory Allocations") are intended to comply with certain requirements of the Regulations. It is the intent of the Members that, to the extent possible, all Regulatory Allocations will be offset with special allocations of other items of Company income, gain, loss and deduction pursuant to this Section 7.4. Therefore, notwithstanding any other provision of this Section 7 (other than the Regulatory Allocations) the Manager shall make offsetting special allocations of Company income, gain, loss or deduction in whatever manner it determines appropriate so that, after such offsetting allocations are made, each Member's Capital Account balance is, to the extent possible, equal to the Capital Account balance such Member would have had if the Regulatory Allocations were not part of the Agreement and all Company items were allocated pursuant to Sections 7.1 and 7.2 hereof.

7.5 Other Allocations Rules.

(a) In accordance with Code ss. 704(c) and the applicable Regulations issued thereunder, income, gain, loss and deduction with respect to any property contributed to the capital of the Company, shall, solely for tax purposes, be allocated among the Members so as to take account of any variation between the adjusted basis of such property to the Company for federal income tax purposes and its initial Gross Asset Value. In the event the Gross Asset Value of any Company property is adjusted pursuant to this Agreement, subsequent allocations of income, gain, loss, and deduction with respect to such asset shall take into account any variation between the adjusted basis of such asset for federal income tax purposes and its Gross Asset Value in the same manner as under Code ss. 704(c) and the Regulations thereunder. Any elections or other decisions relating to such allocations shall be made by the Members in any manner that reasonably reflects the purpose of this Agreement. Allocations made pursuant to this Section 7.5(a) are solely for purposes of federal, state, and local taxes and shall not affect, or in any way be taken into account in computing, any Member's Capital Account or share of Profits, Losses, other items, or Distributions pursuant to any provision of this Agreement.

(b) The Members shall make such other special allocations as are required, from time to time, in order to comply with any mandatory provision of the Regulations or to reflect a Member's economic interest in the Company determined with reference to such Member's right to receive Distributions from this Company and such Member's obligation, if any, to pay its expenses and liabilities.

(c) The Members are aware of the income tax consequences of the allocations made by this Section 7 and hereby agree to be bound by the provisions of this Section 7 in reporting their share of Company income and loss for income tax purposes.

7.6 Capital Account. The Company shall maintain a Capital Account for each Member in accordance with the following provisions:

(a) To each Member's Capital Account there shall be credited such Member's Capital Contributions, such Member's distributive share of Profits and any items in the nature of income or gain which are specifically allocated

pursuant to Sections 7.3 and 7.4 hereof, and the amount of any Company liabilities assumed by such Member or which are secured by any Company property distributed to such Member.

(b) To each Member's Capital Account there shall be debited the amount of cash and the Gross Asset Value of any Company property distributed to such Member pursuant to any provision of this Agreement, such Member's distributive share of Losses and any items in the nature of expenses or losses which are specially allocated pursuant to Sections 7.3 and 7.4 hereof and the amount of any liabilities of such Member assumed by the Company or which are secured by any property contributed by such Member to the Company.

(c) In the event that any interest in the Company is transferred in accordance with the terms of this Agreement, the transferee shall succeed to the Capital Account of the transferor to the extent it relates to the transferred interest.

(d) In determining the amount of any liability for purposes of Subsections (a) and (b) above, there shall be taken into account Code ss. 752(c) and any other applicable provisions of the Code and Regulations.

The foregoing provisions and other provisions of this Agreement relating to the maintenance of Capital Accounts are intended to comply with Regulations ss. 1.704-1(b), and shall be interpreted and applied in a manner consistent with such Regulations. In the event the Manager determines that it is prudent to modify the manner in which the Capital Accounts, or any debits or credits thereto (including, without limitation, debits or credits relating to liabilities that are secured by contributed or distributed property or that are assumed by the Company or the Members), are computed in order to comply with such Regulations, the Manager may make such modification provided it does not affect the amounts distributable to any Member upon the dissolution of the Company. The Manager also shall make any appropriate modifications in the event unanticipated events (for example, the acquisition by the Company of oil or gas properties) might otherwise cause this Agreement not to comply with Regulations ss. 1.704-1(b).

SECTION 8
TRANSFERS OF MEMBERSHIP INTERESTS

8.1 Restrictions on Transfer of Membership Interests. No Member shall make a Transfer of any Membership Interest or any portion thereof (including, without limitation, a Transfer of a right to Profits, Losses, or Distributions to a transferee who does not become a substituted Member) unless approved by the Manager in its sole discretion and in compliance with the requirements of this Section 8.

8.2 Termination of the Company for Tax Purposes. The Transfer of all or any part of a Membership Interest may not be made (and will be invalid) if the interests sought to be transferred, when added to all other interests in the Company's capital and/or profits transferred within the twelve consecutive month period ending on the date of such proposed transfer, would cause the termination of the Company for federal income tax purposes, provided, however, that a Transfer causing such a termination may occur if the Manager consents to that Transfer and acknowledges in writing that the Transfer may cause a termination of the Company for federal income tax purposes.

8.3 Requirements for Transferee Becoming a Substituted Member. No transferee shall become a substituted Member in the Company unless the Transfer is in compliance with Section 8.2 hereof, and the following conditions are satisfied:

(a) the Person to whom the Transfer is to be made shall undertake in writing all of the obligations under this Agreement with respect to the Membership Interest to which the Transfer relates;

(b) all reasonable fees and expenses required in connection with the Transfer shall have been paid by or for the account of the Person to whom the Transfer is to be made; and

(c) all agreements and all other documents shall have been executed and filed and all other acts shall have been performed which the Manager deems necessary to make the Person to whom the Transfer is to be made a substituted Member in the Company and to preserve the status of the Company.

SECTION 9
DISSOLUTION, WINDING UP AND LIQUIDATION OF THE COMPANY

9.1 Dissolution.

(a) The Company shall be dissolved upon the occurrence of any of the following events:

(i) the expiration of its term, as set forth in Section 1.4;

(ii) the written agreement of Members holding a majority-in- interest of the Membership Interests;

(iii) the entry of a decree of dissolution under LLC Act 29-785;

(iv) the acquisition by one Member of all of the outstanding Membership Interests;

(v) the sale of substantially all of the assets of the Company in a single transaction and the collection of all net sales proceeds related thereto; or

(vi) upon the occurrence of any event described in LLC Act ss. 29-733 to the Manager, unless the business of the Company is continued by the specific consent of Members holding a majority (in both capital and profits) of the Membership Interests given within 90 days after such event and there are at least two remaining Members.

(b) As soon as possible following the occurrence of any event causing dissolution of the Company if the Company is not continued, the Manager shall execute and file a notice of winding up with the Arizona Corporation Commission. When all debts, liabilities and obligations have been paid and discharged or adequate provisions have been made therefor and all of the remaining property and assets have been distributed to the Members, Articles of Termination shall be executed and filed with the Arizona Corporation Commission.

(c) Notwithstanding any provisions of this Section 9 to the contrary, if the Company is liquidated within the meaning of Regulations ss. 1.705-2(b)(ii)(G) but none of the events described in Section 9.1(a) hereof have occurred, the Company shall not be liquidated, the Company's liabilities shall not be paid or discharged, and the Company's affairs shall not be wound up. Instead, solely for federal income tax purposes, the Company shall be deemed to have distributed its assets in kind to the Members, who shall be deemed to have assumed and taken subject to all Company liabilities, all in accordance with their respective Capital Accounts and, immediately thereafter the Members shall be deemed to have recontributed all of such assets in kind to the Company, which shall be deemed to have assumed and taken subject to all liabilities.

9.2 Effect of Filing of Dissolving Statement. Upon the dissolution of the Company, the Company shall cease to carry on its business except as may be necessary for the winding up of its business, but its separate existence shall continue until the Articles of Termination have been filed with the Arizona Corporation Commission or until a decree dissolving the Company has been entered by a court of competent jurisdiction.

9.3 Winding Up, Liquidation and Distribution of Assets.f Assets.

(a) Upon dissolution, an accounting shall be made by the Company's independent accountants of the accounts of the Company and of the Company's assets, liabilities and operations, from the date of the last previous accounting until the date of dissolution. The Members shall immediately proceed to wind up the affairs of the Company.

(b) If the Company is dissolved and its affairs are to be wound up, the Manager shall (i) sell or otherwise liquidate all of the Company's assets as promptly as practicable (except to the extent the Manager may determine to distribute any assets to the Members in kind), (ii) allocate any Profits or Losses resulting from such sales to the Members' Capital Accounts in accordance with Section 7 hereof, (iii) discharge all liabilities of the

Company, including all costs relating to the dissolution, winding up, and liquidation and distribution of assets, (iv) establish such reserves as may be reasonably necessary to provide for contingent liabilities of the Company, and (v) distribute all remaining cash and assets of the Company to the Members in accordance with their Capital Accounts. Any amounts withheld as reserves but not ultimately required to discharge liabilities of the Company shall be distributed to the Members as promptly as possible. Distributions to the Members shall be made in accordance with the time requirements set forth in Regulations ss. 1.704-1(b)(2)(ii)(B)(2).

(c) Notwithstanding anything to the contrary in this Agreement, upon a liquidation within the meaning of Regulations ss. 1.704-1(b)(2)(ii)(G), if any Member has a negative deficit Capital Account balance (after giving effect to all contributions, distributions, allocations and other Capital Account adjustments for all taxable years, including the year during which such liquidation occurs), such Member shall have no obligation to make any contribution to the capital of the Company, and the negative balance of such Member's Capital Account shall not be considered a debt owed by such Member to the Company or to any other person for any purpose whatsoever.

(d) Upon completion of the winding up, liquidation and distribution of the assets and filing of the Articles of Termination, the Company shall be deemed terminated.

9.4 Return of Contribution Nonrecourse to Other Members. Except as provided by law, upon dissolution, each Member shall look solely to the assets of the Company for the return of his Capital Contributions. If the Company property remaining after the payment or discharge of the debts and liabilities of the Company is insufficient to return the Capital Contributions of one or more Members, such Member or Members shall have no recourse against any other Member.

SECTION 10
BOOKS AND RECORDS OF THE COMPANY; ACCOUNTING AND TAX MATTERS

10.1 Nature of Books and Records. The Manager shall maintain or cause to be maintained complete and accurate records and books of account appropriate for the Company's business and affairs. Such books and records shall be kept on a basis consistent with the accounting methods followed by the Company for federal income tax purposes.

10.2 Review; Audit. At the discretion of the Manager, the books of the Company may be reviewed or audited annually at Company expense by such national independent public accounting firm as the Manager shall designate.

10.3 Elections by Company as to Optional Adjustment to Basis. In the case of a distribution of property within the provisions of Code ss. 734 or in the case of a Transfer of a Membership Interest permitted by this Agreement made within the provisions of Code ss. 743, the Manager on behalf of the Company may, at its option, file an election under Code ss. 754 in accordance with the procedures set forth in the applicable Regulations. If such an election is filed, the Manager shall provide any additional accounting or tax information with respect to any adjustment to basis for any Member.

10.4 Election With Respect to Taxation as Company. No election shall be made under Code ss. 761 to exclude the Company from the application of any of the provisions of Subchapter K, Chapter 1 of the Code.

10.5 Names and Addresses of Members. The Manager shall maintain a current alphabetical list of the full names and last known business addresses of all Members at the principal office of the Company. Such list shall be made available for the review of any Member or his representative at reasonable times and, upon request either in person or by mail, the Manager shall furnish a copy of such list to any Member or his representative for the cost of reproduction and mailing.

10.6 Fiscal Year. The fiscal year of the Company shall end on December 31 of each year.

10.7 Tax Returns. Within ninety (90) days after the end of each fiscal year of the Company, the Manager shall cause a nationally certified audit firm to prepare a U.S. partnership return of income and any applicable state or local

returns of income for the Company and, in connection therewith, shall make any available or necessary elections. Within such ninety (90) day period, the Company shall furnish to the Members information required to be set forth in each Member's individual federal income tax return. The Company's U.S. partnership returns of income, and any applicable state or local returns of income, for the three most recent fiscal years of the Company shall be kept at the Company's principal office.

10.8 Financial Information. The Manager shall furnish to each Member from time to time or upon reasonable demand true and full information regarding the business and financial condition of the Company. Such financial information for the three most recent fiscal years of the Company shall be kept at the Company's principal office.

10.9 Records. The Manager shall keep or cause to be kept at the Company's principal office (a) full and accurate records of all transactions of the Company for the three most recent fiscal years, (b) a copy of the Articles of Organization and all Articles of Amendment thereto together with executed copies of any powers of attorney pursuant to which any such document has been executed, (c) copies of the then effective Agreement and (d) copies of any financial statements of the Company for its three most recent fiscal years.

10.10 Access to Records. Each Member and its designated representatives shall be permitted access to all records of the Company at the principal office of the Company during ordinary business hours and shall have the right to make copies thereof at their own expense. Upon written request, after payment of the reasonable expenses of duplication, a Member shall be provided with a copy of the Articles of Organization and any Articles of Amendment thereto. The Company shall not otherwise be required to deliver or mail a copy of the Articles of Organization or any Articles of Amendment thereto. The Members shall have the further right to obtain from the Manager from time to time upon reasonable demand (i) true and full information regarding the state of the business and financial condition of the Company, (ii) promptly after becoming available, a copy of the Company's federal, state and local income tax returns for such year and (iii) such other information regarding the affairs of the Company as is just and reasonable within the meaning of the LLC Act.

SECTION 11
MISCELLANEOUS PROVISIONS

11.1 Notices. All notices and other communications required or permitted to be given pursuant to this Agreement shall be in writing and shall be deemed to have been duly given, made and received only when delivered against receipt or when deposited in the United States mails, first class, postage prepaid, return receipt requested, addressed to the addressee at his address as shown from time to time in the records of the Company. Any Member may alter the address to which communications are to be sent by giving written notice of such change of address to the Manager in conformity with the provisions of this Section.

11.2 Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors, heirs, personal representatives and assigns.

11.3 Controlling Law. This Agreement shall be governed by and construed in accordance with the laws of the state of Arizona without respect to its internal laws governing conflicts. The venue for any dispute arising hereunder shall be Maricopa County, Arizona

11.4 Provisions Severable. If any provision of this Agreement shall be or shall become illegal or unenforceable in whole or in part, for any reason, the remaining provisions shall be nevertheless be deemed valid, binding and subsisting.

11.5 Indulgences Not Waivers. Neither the failure nor any delay on the part of any party to exercise any right, remedy, power or privilege under this Agreement shall operate as a waiver thereof, nor shall any single or partial exercise of any right, remedy, power or privilege preclude any other or further exercise of any other right, remedy, power or privilege nor with respect to any occurrence be construed as a waiver of such right, remedy, power or privilege with respect to any subsequent occurrence.

11.6 Titles Not to Affect Interpretation. The titles of sections, paragraphs and subparagraphs contained in this Agreement are inserted for the convenience of reference only, and they neither form a part of this Agreement nor are they to be used in the construction or interpretation thereof.

11.7 Gender. Words used herein, regardless of the number or gender specifically used, shall be deemed and construed to include any other number, singular or plural, and any other gender, masculine, feminine or neuter, as the context requires.

11.8 Execution In Counterpart. This Agreement may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument, and any persons signatory hereto may execute this Agreement by signing any such counterpart.

11.9 Statutory Provisions. Any statutory references in this Agreement shall include a reference to any successor to such statute.

11.10 Waiver of Action for Partition. Each Member irrevocably waives during the term of the Company any right that such Member have to maintain any action for partition with respect to the property of the Company.

IN WITNESS WHEREOF, the parties have executed this Agreement effective as of the day and year first above written.

"ACM"
ACM Investments, L.L.C., an Arizona limited company

By: Great Western Development Corporation, an Arizona corporation, Manager

/s/Alan R, Mishkin
By: Alan R. Mishkin, President

"OLD NATUS"
Natus Corporation, a Minnesota corporation

/s/Kathleen A. Billings
By: Kathleen A. Billings
Its: President

"MANAGER"
Natus Management, Inc., an Arizona corporation

/s/Richard J. Bennetts
By: Richard J. Bennetts
Its: President

CONFIDENTIAL

MARKETING AND DISTRIBUTION AGREEMENT

THIS AGREEMENT is made and entered into as of the 11th day of January, 1996 between CNS, Inc., a Delaware corporation ("Distributor"), Natus Corporation, a Minnesota corporation ("Natus"), and LecTec Corporation, a Minnesota corporation ("LecTec") (Natus and LecTec are collectively referred to herein as "Manufacturer").

BACKGROUND

LecTec manufactures the Product (as defined below) and Natus has rights to the Product. Manufacturer is the owner of the Product. Distributor is in the business of manufacturing and marketing consumer medical products and has established sales channels for such products. Manufacturer desires to enter into a marketing and distribution agreement for the Product on the terms and conditions set forth in this Agreement

TERMS AND CONDITIONS

NOW THEREFORE, in consideration of the mutual promises contained herein, the parties hereto agree as follows:

1. Definitions. For purposes of this Agreement, the following terms shall be defined in the manner set forth below:

1.1 "Product" shall mean Manufacturer's topical analgesic pain relief patch containing any of the active ingredients methyl salicylate, menthol and camphor, and all alterations of and improvements to such Product; provided, however, that Manufacturer may not alter the Product without Distributor's approval which approval shall not be unreasonably withheld.

1.2 "Territory" shall mean the United States of America and Canada, and all of their possessions and territories.

1.3 "Exclusive Market" shall mean all retail stores in the Territory and all wholesalers serving those retail stores.

1.4 "Non-Exclusive Market" shall mean those retail channels in the Territory other than the channels in the Exclusive Market; provided, however, that the Non-Exclusive Market shall not include (i) direct response infommericals and electronic retailing through television-based shopping programs such as (but not limited to) QVC and HSN, or (ii) direct person to person marketing, including multi-level distributorships.

1.5 "Growth Factor" for any one calendar year shall mean the product of Distributor's minimum purchase obligation for the prior year and the total growth in the United States' retail topical analgesic market for such prior year as measured by Information Resources, Inc. ("IRI") or Nielson Rating Services ("Nielson") scanner data.

2. APPOINTMENT OF DISTRIBUTOR.

2.1 Subject to the terms and conditions contained herein, Manufacturer grants to the Distributor, and the Distributor hereby accepts, the rights and responsibilities of (i) an exclusive distributor of the Product in the Exclusive Market in the Territory and (ii) a non-exclusive distributor of the Product in the Non-Exclusive Market in the Territory. Distributor is prohibited from selling the Product outside the Exclusive Market or Non-Exclusive Market or to any customer who is not in the Territory. In addition, Distributor is hereby granted a right of first refusal to act as exclusive distributor in the Exclusive Market of any analgesic patch developed by the Manufacturer other than the Product. Such right of first refusal shall

expire on the first anniversary of the commencement of test marketing of the Product hereunder.

2.2 Beginning on January 1, 1996 and during the Term of this Agreement, Manufacturer shall maintain Distributor's exclusivity in the Exclusive Market in the Territory by not appointing any sales representatives or distributors, or selling directly through other outlets in the Exclusive Market in the Territory. Nothing contained herein shall in any manner restrict or limit Manufacturer in regard to appointing another distributor for the Product or in regard to selling directly or through other outlets in the Non-Exclusive Market. Distributor acknowledges that Manufacturer has granted to a third party certain rights to sell the Product in the Exclusive Market under the trademark "Natus Patch," which rights are terminable by Manufacturer, and that on January 1, 1996 Manufacturer will give notice to such party to terminate such third party's rights to sell the Product in the Exclusive Market effective January 30, 1996.

2.3. Each of the parties is an independent contractor and nothing contained herein shall be deemed or construed to create the relationship of an agency, partnership, joint venture, franchise or any other association or relationship between the parties except that of a marketing and distributor relationship. Distributor is not granted any right or authority to assume or create any obligations or responsibilities, express or implied, on behalf or in the name of, Manufacturer or to bind Manufacturer in any manner or thing whatsoever, without the prior written approval and acceptance by Manufacturer in each instance.

3. PURCHASE ORDERS.

3.1 No purchase orders of Distributor shall be binding upon Manufacturer until accepted by Manufacturer in writing. Except as otherwise agreed in writing by Manufacturer, an order may not be canceled by Distributor after it has been accepted.

3.2 All sales of Product by Manufacturer to Distributor hereunder shall be subject to the provisions of this Agreement and shall not be subject to the terms and conditions contained in any purchase order of Distributor or confirmation of Manufacturer, except insofar as any such purchase order or confirmation establishes (i) the quantity of Product to be sold or (ii) the shipment date of Product.

4. SHIPMENT OF PRODUCT.

4.1 Subject to delay due to force majeure, Manufacturer will ship Product on the date indicated in Distributor's purchase order if such order is within the then current sales projection of Distributor. If such order is beyond the projection, Manufacturer will use commercially reasonable efforts to meet such order and will not unreasonably withhold or delay its acceptance of the order.

4.2 All Product sold by Manufacturer to Distributor hereunder will be shipped by Manufacturer F.O.B. LecTec's loading dock ("Shipping Point").

4.3 Distributor shall assume all risk of loss for Product upon delivery by Manufacturer of the Product to the Shipping Point.

4.4 Distributor will pay all loading, freight, shipping, insurance, forwarding and handling charges, taxes, storage, and all other charges applicable to the Product after it is delivered by Manufacturer to the Shipping Point.

5. PRICE AND PAYMENT.

5.1 Manufacturer agrees to sell the Product to Distributor F.O.B. Shipping Point at the price set forth on Exhibit A. Prices may not be changed without Distributor's prior approval and changes will be based on the national consumer price index.

5.2 The parties agree to renegotiate in good faith the price paid by Distributor for the Product in the following situations: (i) for specified packout configurations, for which different prices will be based on any cost savings or increases that Manufacturer incurs as a result of such packout changes, (ii)) in the event price elasticity or competitive pricing

pressures impact Distributor's ability to effectively penetrate the market, in which case the new prices will be negotiated in good faith; and (iii) to share manufacturing cost reductions with Distributor in the event that unit sales of the Product reach sufficient sustainable volume to generate manufacturing economies of scale, in which case the new prices will be negotiated in good faith with the understanding that the parties will take into consideration any cost saving experienced by Distributor in connection with its marketing efforts.

5.3 Manufacturer agrees that it will not (i)) sell comparably-sized Product to any other party in the Non-Exclusive Market at a price less than the price paid by Distributor or (ii) sell comparably-sized Product to any other party at a price less than the price paid for the Product by Distributor. The restriction in Section 5.3(ii) shall not apply to sales under (a) agreements existing as of the date of this Agreement or (b) agreements for sales through direct person to person marketing, including multi-level distributorships.

5.4 Except as otherwise provided in this Agreement, Distributor shall pay Manufacturer for each shipment of Product within thirty (30) days of the date of the invoice issued by Manufacturer in conjunction with such shipment.

6. RETURNED GOODS POLICY. Distributor may return Product to Manufacturer upon Manufacturer's prior written approval if such Product deviated from Distributor's packaging specifications or if the Product or packaging does not meet the warranties contained in Section 13.1. Complaints concerning conditions of any Product or packaging must be made within fifteen (15) days of receipt by Distributor of such Product. Manufacturer shall pay all freight charges incurred in connection with any return of Product pursuant to this returned goods policy.

7. MANUFACTURER'S RESPONSIBILITIES.

7.1 In support of Distributor's sales efforts to promote Product in the Territory, Manufacturer will furnish, at no cost to Distributor, (i) to the extent known and available to Manufacturer, medical literature regarding or relating to the Product, including abstracts of clinical studies and medical journal articles, (ii) sales and promotional materials as may be developed by Manufacturer, limited to technical data and technical journal reprints, and (iii) samples of Product in reasonable quantities, as requested by Distributor and agreed to by Manufacturer, each acting in good faith. Manufacturer will furnish information to aid in the orientation and training of Distributor's service and sales personnel.

7.2 Manufacturer will package the Product in conformance with the packaging specifications provided by Distributor. Distributor will provide camera-ready artwork for labels and packaging.

7.3 Manufacturer shall take such actions as are necessary (such as cutting off supply of Product) to prevent any domestic or foreign entity from distributing or selling, directly or indirectly, the Product in the Exclusive Market in the Territory.

7.4 Manufacturer shall, with the exception of an IND, underwrite the cost of any clinical studies necessary to support the Citizens Petition or other similar FDA filings. Distributor and Manufacturer shall jointly underwrite the cost of any mutually agreed upon clinical studies intended to broaden Product claims beyond the monograph. Neither party shall be obligated to file an IND or perform any clinical studies with respect to the Product.

7.5 Manufacturer shall give Distributor 180 days' written notice prior to discontinuing the manufacture of the Product and shall not discontinue manufacturing the Product prior to December 31, 1997 without Distributor's written approval, unless the Food and Drug Administration forbids production or distribution of the Product.

7.6 Manufacturer shall maintain a 30-day inventory of Product to meet Distributor's forecasted volume requirements provided to Manufacturer pursuant to Section 8.2.

8. DISTRIBUTOR'S RESPONSIBILITIES. In addition to the duties and responsibilities outlined elsewhere in this Agreement, Distributor agrees as

follows:

8.1 Distributor will vigorously promote the sale and acceptance of Product throughout the Territory. Distributor shall provide its customers with all necessary and appropriate training and support regarding the use of the Product.

8.2 Distributor shall furnish to Manufacturer a written four-month rolling forecast for the Product, which forecast shall be given to Manufacturer on or before the 10th day of each month.

8.3 Distributor shall underwrite the cost of any comparative clinical studies for the Product. Distributor and Manufacturer shall jointly underwrite the cost of any clinical studies intended to broaden Product claims beyond the monograph, which are mutually agreed upon by the parties.

8.4 Claims language in all advertising or promotional materials utilized by Distributor, its agents or employees in conjunction with the sale of Product, other than such sales literature as is furnished to Distributor by Manufacturer, shall be approved, in writing, by Manufacturer prior to their use or dissemination.

8.5 Distributor shall cooperate fully with Manufacturer in dealing with customer complaints concerning the Product and shall take such action to resolve such complaints as may be requested by Manufacturer.

8.6 Distributor agrees, during the term of this Agreement, to comply with all FDA regulations applicable to the Product. Distributor shall not, in any way, misrepresent the nature or indications for use of the Product or, except by prior written approval of Manufacturer, alter the Product.

9. MINIMUM PURCHASE OBLIGATIONS AND RETAIL STORE PLACEMENTS.

9.1 During the term of this Agreement, Distributor shall purchase a minimum number of Product from Manufacturer per calendar year and shall have the Product placed in a minimum number of retail stores as of December 31 of each year, as set forth below.

9.1.1

Year	Number of Patches
1996	(Confiidential Treatment Has Been Requested)
1997	(Confiidential Treatment Has Been Requested)
1998	(Confiidential Treatment Has Been Requested)
Thereafter	(Confiidential Treatment Has Been Requested)

9.1.2

Year	Number of Stores
1996	(Confiidential Treatment Has Been Requested)
1997	(Confiidential Treatment Has Been Requested)
Thereafter	(Confiidential Treatment Has Been Requested)

The above minimums assume that test marketing of the Product will begin by May 1, 1996. If test marketing begins later, the parties shall renegotiate the minimums in good faith.

9.2 The minimum purchase obligation for 1997 may be satisfied by achieving a combined volume of (Confidential Treatment Has Been Requested) patches during 1996 and 1997.

9.3 During years 1996, 1997 and 1998, Distributor's obligations under this Section 9 may be satisfied by achieving either the Product minimums or retail store minimums determined through IRI or Nielson data and store purchase data, records of which may be reviewed by Manufacturer.

9.4 In the event that Manufacturer loses its Product deferral with the FDA and, as a consequence, Distributor is prohibited from selling the Product, the minimum requirements set forth above shall be waived.

9.5 In the event Distributor shall fail to meet any minimum requirements as set forth in this Section 9, Distributor shall have defaulted under this Agreement, and Manufacturer's exclusive remedy is to terminate this Agreement pursuant to Section 10; provided, however, that after 1998, Distributor shall not be in breach of this Section 9 and Manufacturer may not terminate this Agreement until (i) Distributor shall have failed to meet any of

its minimum requirements, (ii) Manufacturer has given Distributor a 30-day written notice of such failure, and (iii) Distributor fails to meet the minimum requirements after an additional six-month period to cure.

9.6 The minimums stated above will be appropriately reduced by good faith negotiation of the parties (i) if Manufacturer does not use reasonable efforts to defend its patents, (ii) if Manufacturer does not obtain or maintain the necessary governmental or regulatory approvals to sell the Product or (iii) where the parties are unable to agree on the price of the Product pursuant to in paragraph 5.2(ii) hereof.

10. TERM OF AGREEMENT: TERMINATION.

10.1 This Agreement shall commence on the date hereof and terminate on the later of (i) expiration of the last of Manufacturer's United States patents on the Product issued or pending as of the date of this Agreement and (ii) any other patent issued or pending or application filed on the Product after the date hereof

10.2 Either party may terminate this Agreement by giving thirty (30) days' written notice to the other party of any material breach provided that as of the expiration of said thirty (30) day notice period and an additional sixty (60) days' cure period such breach remains uncured (other than as set forth in Section 9.5)(iii).

10.3 Either party may terminate this Agreement immediately upon written notice to the other party if the other party shall: (i) file a voluntary petition in bankruptcy or be the subject of an involuntary petition in bankruptcy which is not dismissed within thirty (30) days of the date of filing; (ii) be voluntarily or involuntarily dissolved; or (iii) have a receiver, trustee or other court officer appointed for its property in connection with any such bankruptcy proceeding, liquidation or insolvency proceeding.

10.4 Termination of this Agreement shall not relieve Manufacturer of its obligations to deliver all Product ordered by Distributor and accepted by Manufacturer prior to such termination; nor will such termination relieve Distributor of its obligation to accept and pay for all Product ordered by Distributor under purchase orders issued by Distributor and accepted by Manufacturer prior to the date of such termination. Termination shall not relieve or release either party from its obligation to make any other payments which may be owing to the other party under the terms of this Agreement or from any other liability which either party may have to the other arising out of this Agreement or the breach of this Agreement. Following notice of termination, Manufacturer shall have no obligation to accept any orders for Product from Distributor.

10.5 Upon termination of this Agreement for breach by Manufacturer or for breach by Distributor of its minimum purchase obligations or minimum store placements hereunder, Distributor shall have the right, but not the obligation, to cause Manufacturer to repurchase all Product having at least 50% of its original shelf life in possession of Distributor, at the lower of Distributor's original invoice purchase price or the then current invoice price, provided, that such Product is new, unused and not materially damaged. Manufacturer agrees to buy said Product from Distributor for said price should Distributor exercise this right.

10.6 Upon termination of this Agreement for breach by Distributor (other than a breach by Distributor of its minimum purchase obligations or minimum store placements hereunder), Manufacturer shall have no obligation to repurchase Distributor's inventory of Product, and shall have the right, but not the obligation, to cause Distributor to purchase, at the then current price, Manufacturer's 30 day inventory of Product as required to be held by Manufacturer pursuant to Section 7.6, having at least 50% of its original shelf life in Manufacturer's possession, provided, that such Product is new, unused and not materially damaged. Distributor agrees to buy said Product from Manufacturer for said price should Manufacturer exercise this right.

10.7 Notwithstanding anything contained herein to the contrary, Sections 12, 13 and 19 of this Agreement shall survive termination of this Agreement and shall remain in full force and effect.

11. Waiver of Breach. The waiver or failure of either party to enforce the terms of this Agreement in one instance shall not constitute a

waiver of said party's rights under this Agreement with respect to other violations.

12. MANUFACTURER'S WARRANTIES AND REPRESENTATIONS: INDEMNIFICATION.

12.1 Manufacturer warrants that the Product and its packaging (i) are free from defects in material and manufacture, (ii) are fit to be used as indicated in the Product labeling, (iii) meet all specifications and performance claims, and (iv) are not adulterated or misbranded (as defined by the FDA). If a Product or the packaging does not meet its warranty, Manufacturer shall replace such Product or packaging or refund Distributor's purchase price. In case of a recall, Manufacturer shall reimburse Distributor for its reasonable costs in assisting in the recall.

THE WARRANTIES SET FORTH ABOVE ARE IN LIEU OF ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, WHICH ARE HEREBY DISCLAIMED AND EXCLUDED BY MANUFACTURER, INCLUDING WITHOUT LIMITATION ANY WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OF USE, EXCEPT AS EXPRESSED ABOVE IN PARAGRAPH 12.1.

12.2 Manufacturer will comply with all material laws and regulations, including FDA GMPs with respect to the manufacturing, packaging and labeling of the Products. Distributor may periodically audit procedures, processes, process controls and manufacturing records of Manufacturer.

12.3 Each of LecTec and Natus has been duly incorporated and is validly existing as a corporation in good standing under the laws of the State of Minnesota and the undersigned has been duly authorized to execute this Agreement on behalf of the Manufacturer, and when so executed, this Agreement will constitute the valid and binding obligation of Manufacturer, enforceable in accordance with its terms.

12.4 Manufacturer has the exclusive right, under the applicable patents related to the Product, to manufacture the Product, for the duration of such patents, in the United States and Canada and Manufacturer has obtained clearance to market the Product in the United States from the FDA. It will use commercially reasonable efforts to obtain clearance from the Ministry of Health to market the Product in Canada taking into account the costs of obtaining such clearance and the anticipated market for the Products in Canada.

12.5 LecTec and Natus shall jointly and severally save Distributor, its directors, officers and employees from and against and indemnify them from any and all claims, liabilities, costs and expenses of any nature (including attorney's fees) caused by reason of claim that the Product caused personal injury or property damage; provided, however, that Manufacturer's indemnification obligations are conditioned upon Distributor giving Manufacturer prompt written notice of any such claims and allowing Manufacturer to participate in its own defense with its own counsel.

12.6 Manufacturer shall maintain product liability insurance coverage in the amount of $2 million per occurrence which will be renewed annually and which shall name Distributor as an additional named insured.

12.7 No party shall be liable to another party for any consequential damages (e.g., lost profits, business opportunities or investments) that arise as a result of this Agreement or its termination.

13. DISTRIBUTOR'S REPRESENTATIONS: INDEMNIFICATION.

13.1 Distributor shall not make any statements concerning the Product which are not approved by Manufacturer, and any such statements by Distributor shall be the sole responsibility of Distributor and Distributor shall save Manufacturer, its directors, officers and employees harmless against and indemnify them from the liability, costs, and expenses of any nature (including attorneys' fees) which Manufacturer may incur as the result of any such statements; provided, however, that Distributor's indemnification obligations are conditioned upon Manufacturer giving Distributor prompt written notice of any such claims and allowing Distributor to participate in its own defense with its own counsel.

13.2 Distributor has been duly incorporated and is validly existing as a corporation in good standing under the laws of the State of Delaware and the undersigned has been duly authorized to execute this Agreement

on behalf of the Distributor, and when so executed, this Agreement will constitute the valid and binding obligation of Distributor, enforceable in accordance with its terms.

14. TRADEMARKS AND TRADE NAMES.

14.1 Manufacturer hereby grants to Distributor the exclusive license to use the "TheraPatch(TM)" trade name for use in the Territory in connection with the advertising and sale of the Product. If at any time Distributor markets the Product under a trade name other than "TheraPatch," the exclusive license granted pursuant to this Section 14.1 shall terminate. Distributor will discontinue the use of such trade name at the end of this Agreement. If Distributor uses the TheraPatch name in connection with the advertising and sale of the Product, Distributor shall indicate on package labeling of the Product that the product is manufactured by LecTec and that "TheraPatch" is a trademark of the Manufacturer."

14.2 Distributor is hereby granted the first right of negotiation to acquire the trade name "TheraPatch." Such right of negotiation shall expire on the first anniversary of the commencement of test marketing of the Product hereunder.

14.3 Distributor shall not remove, cover, change, or add to the labels affixed by Manufacturer to Product without first receiving Manufacturer's written approval.

15. PATENT OR TRADEMARK INFRINGEMENT.

15.1 If a patent infringement action is commenced or threatened against Manufacturer as to any Product and Manufacturer elects to, as a result, discontinue the sale of the Product in any part or all of the Territory, Distributor shall discontinue its efforts to sell said Product in any such part or all of the Territory immediately upon receipt of written notice thereof from Manufacturer. LecTec and Natus shall jointly and severally save Distributor, its directors, officers and employees harmless from and against and indemnify them from any and all claims, liabilities, costs and expenses of any nature (including attorney's fees) caused by reason of claims that the Product infringes the intellectual property rights of others (e.g., patent, copyright, trademark, trade name, etc.); provided, however, that Manufacturer's indemnification obligations are conditioned upon Distributor giving Manufacturer prompt written notice of any such claims and giving the defense of the claim to Manufacturer and reasonably cooperating with Manufacturer in the defense. Distributor shall have a right to cooperate in its own defense with its own counsel.

15.2 Distributor shall promptly notify Manufacturer in the event Distributor becomes aware of any activities of a third party that may constitute infringement of the Manufacturer's patents or pending patents on the Product or trademarks.

16. Recall. Distributor shall maintain complete and accurate records of all Product sold by Distributor, its agents or employees (including without limitation a complete and current list of all customers who have purchased, the date of such purchases and the lot numbers of the units purchased). In the event of a recall of any of the Product, Distributor will cooperate fully with Manufacturer in effecting such recall, including without limitation, promptly contacting any purchasers Manufacturer desires be contacted during the course of any such recall, and promptly communicating to such purchasers such information or instructions as Manufacturer may desire be transmitted to such purchasers.

17. Traceability . Distributor agrees to comply with all traceability programs in effect at any time as initiated by Manufacturer. Manufacturer may examine and make transcripts of any records required as part of a traceability program at reasonable times during business hours.

18. Appointment of Subdistributors. In the event Distributor appoints any subdistributors or sales representatives in the Territory in connection with the performance of this Agreement, such appointment shall be made only in the name and for the account of Distributor and shall be for a term no greater than the term of this Agreement. Distributor shall not grant to the subdistributors and/or sales representatives any rights greater than those which are granted by Manufacturer to Distributor under this Agreement. Distributor shall also impose on the subdistributors and/or sales representatives the same obligations as

Manufacturer has imposed on Distributor under this Agreement.

19. Confidential Information. Manufacturer and Distributor may exchange information each considers confidential ("Confidential Information"). "Confidential Information" shall include any information that is not generally known, including trade secrets, outside of that disclosing party and that is proprietary to that party, relating to any phase of that party's existing or reasonably foreseeable business which is disclosed to the receiving parties during the term of this Agreement. "Confidential Information" does not include information that (i) is or becomes publicly available through no fault of the receiving parties, (ii) is in the possession of the receiving parties prior to the receipt from the disclosing party, (iii) is developed by the receiving party independently of the Confidential Information, or (iv) is given to the receiving party by someone else who has the right to do so. Each party hereto specifically agrees to keep confidential and not to disclose to others any and all Confidential Information. Upon the request of the disclosing party, or in the event of the expiration or other termination of this Agreement, the receiving parties shall promptly return all such Confidential Information to the disclosing party. Each party hereto agrees not to use any such Confidential Information except in conjunction with the purposes of this Agreement. The duty not to disclose or use (other than in conjunction with the performance of this Agreement) such Confidential information shall survive the termination of this Agreement.

20. Force Majeure. Neither Manufacturer nor Distributor shall be in breach of this Agreement for a failure to perform or be liable to the other for any failure to perform under this Agreement if such failure is caused, in whole or in part, directly or indirectly, by strikes, lockouts, or any other labor troubles, fires, floods, acts of God, accidents, embargoes, war, riots, act or order of any government or governmental agency, delay in the delivery of raw material parts, or completed merchandise by the supplier thereof or any other cause beyond the control of, or occurring without the fault of, such party.

21. Notice. All notices under this Agreement shall be in writing, and may be delivered by hand or sent by mail or facsimile transaction. Notices sent by mail shall be sent by registered mail return receipt requested, and shall be deemed received on the date of receipt indicated by the receipt verification provided by the United States postal service. Notices delivered by hand or facsimile transaction shall be effective upon receipt. Notices shad be given, mailed, or sent to the parties at the following addresses:

If to LecTec:	*With a copy to:*
LecTec Corporation *10701 Red Circle Drive* *Minnetonka, MN 55343* *Attn: Thomas E. Brunelle, Ph.D.* *Phone: (612) 933-2291* *Fax: (612) 933-1068*	*Dorsey & Whitney P.L.L.P.* *Pillsbury Center South* *220 South 6th Street* *Minneapolis, MN 55402* *Attn: Karin Keitel* *Phone: (612) 340-8809* *Fax: (612) 340-8738*
If to Natus:	*With a copy to:*
Natus Corporation *4550 W. 77th Street* *Edina, MN 55435* *Attn: Kathleen A. Billings* *Phone: (612) 835-4626* *Fax: (612) 835-2317*	*Dorsey & Whitney P.L.L.P.* *Pillsbury Center South* *220 South 6th Street* *Minneapolis, MN 55402* *Attn: Karin Keitel* *Phone: (612) 340-8809* *Fax: (612) 340-8738*
If to Distributor:	*With a copy to:*
CNS, Inc. *P.O. Box 39802* *Minneapolis, MN 55439* *Attn: Richard E. Jahnke* *Phone: (612) 820-6696* *Fax: (612) 820-6697*	*Lindquist & Vennum P.L.L.P.* *4200 MS Center* *80 South 8th Street* *Minneapolis, MN 55402* *Attn: Patrick Delaney* *Phone: (612) 371-3281* *Fax: (612) 371-3207*

Any party hereto may designate any other address for notices given it hereunder for written notice to the other party given at least ten (10) days

prior to the effective date of such change.

22. ENTIRE CONTRACT There are no oral or other agreements or understandings between the parties affecting this Agreement or relating to the selling or purchase of Product. This Agreement supersedes all previous oral and written arrangements between the parties, including their letter of intent dated October 10, 1995, and is intended as a complete and exclusive statement of the terms of their understanding.

23. AMENDMENTS. Amendments, if any, shall be in writing and valid only when signed by all parties.

24. ASSIGNABILITV. No party may assign this Agreement without the written consent of the other parties; provided, however, that either party may assign this Agreement without such consent to any majority-owned or controlled affiliate or subsidiary.

25. SEVERABILITY. In the event that any provision of this Agreement is held invalid by the final judgment of any court of competent jurisdiction, the remaining provisions shall remain in full force and effect as if such invalid provision had not been included herein.

26. REMEDIES. The parties acknowledge that money damages may not be an adequate remedy for any breach of the provisions of this Agreement and that, in addition to any other relief afforded by law, an injunction against such violation may be issued against it and every other person concerned thereby, it being understood that both damages and an injunction shall be proper modes of relief and are not to be considered mutually exclusive remedies. In the event of any such violation, the parties agrees to pay, in addition to the actual damages sustained by the other parties as a result thereof, the reasonable attorneys' fees incurred by such party in pursuing any of its rights under this Agreement.

27. ACTION FOR BREACH. The time within which Manufacturer or Distributor may bring an action for breach of this Agreement shall be one year from the date of knowledge of such breach. No action may be commenced after that one-year period.

28. DISPUTES: APPLICABLE LAW AND FORUM SELECTION. Except as altered or expanded by this Agreement, the substantive law (and not the law of conflicts) of the State of Minnesota shall govern this Agreement in all respects as to the validity, interpretation, construction and enforcement of this Agreement and all aspects of the relationship between the parties hereto. Any disputes between the parties hereto relating to any provision hereof shall be settled by submission for arbitration at the Minneapolis, Minnesota office of the American Arbitration Association under the then current rules of the American Arbitration Association. Notwithstanding the foregoing, nothing herein shall prevent a party from seeking and obtaining equitable relief in a court of competent jurisdiction solely for the purpose of protecting such party's rights, pending a final decree of the arbitrator.

IN WITNESS WHEREOF, the parties have herunto set their hands ^I as of the day and year first above written

LECTEC CORPORATION

By: /s/Thomas E. Brunelle
Thomas E. Brunelle, Ph.D
Chairman, President and CEO

NATUS CORPORATION

By: /s/Kathleen A. Billings
Kathleen A. Billings, President and CEO

CNS, INC.

By: /s/Richard J. Jahnke
Richard J. Jahnke, President and COO

Exhibit A

PRICES

(Confidential Treatment Has Been Requested)

CREDIT AGREEMENT

THIS CREDIT AGREEMENT is made and entered into as of May 1, 1996, by and between LECTEC CORPORATION, a Minnesota corporation (the "Borrower"), whose address is 10701 Red Circle Drive, Minnetonka, Minnesota 55343, and FIRST BANK NATIONAL ASSOCIATION, a national banking association (the "Lender"), whose address is 300 Prairie Center Drive, Eden Prairie, Minnesota 55344.

RECITALS

FIRST: Pursuant to one or more agreements ("Prior Loan Agreements"), the Lender has made available to the Borrower a revolving line of credit ("Line of Credit") in the maximum principal amount of One Million and No/100 Dollars ($1,000,000.00) evidenced by a promissory note dated January 2, 1996 made by the Borrower payable to the order of the Lender ("Prior Revolver").

SECOND: The Borrower has requested that the Lender extend the maturity date of the Line of Credit and revise the rate at which interest accrues thereon and the Lender has indicated its willingness to accommodate such request, subject, however, to certain terms and conditions.

NOW, THEREFORE, for and in consideration of the loans and advances to be made by the Lender to the Borrower hereunder, the mutual covenants, promises and agreements contained herein, and other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the Borrower and the Lender agree as follows:

The following terms when used in this Credit Agreement shall, except where the context otherwise requires, have the following meanings both in the singular and plural forms thereof:

1. DEFINITIONS

"Account" means any right of the Borrower to payment for goods sold or services rendered.

"Advance" means any advance by the Lender made under the Revolving Credit Commitment. The face amount of any Letter of Credit shall be deemed an Advance hereunder.

"Affiliate" means any corporation, association, partnership, joint venture or other business entity directly or indirectly controlling or controlled by, or under direct or indirect common control of, the Borrower or any of its Subsidiaries.

"Borrower" means LecTec Corporation, a Minnesota corporation.

"Business Day" means any day (other than a Saturday, Sunday or legal holiday in the State of Minnesota) on which national banks are permitted to be open in Minneapolis, Minnesota and, with respect to Advances to bear interest at the Eurodollar Rate, a day on which dealings in United States dollars may be carried on by the Lender in the interbank eurodollar market.

"Credit Agreement" means this Credit Agreement, as originally executed and as may be amended, modified, supplemented, or restated from time to time by written agreement between the Borrower and the Lender.

"Current Assets" means, at any date, the aggregate amount of all assets of the Borrower that are classified as current assets in accordance with GAAP.

"Current Liabilities" means, at any time, the aggregate amount of all liabilities of the Borrower that are classified as current liabilities in accordance with GAAP (including taxes and other proper accruals and the matured portion of any indebtedness).

"Current Ratio" means, at any date, the ratio of the Borrower's Current Assets to its Current Liabilities.

"Debt" means (i) all items of indebtedness or liability that, in accordance with GAAP, would be included in determining total liabilities as shown on the liabilities side of a balance sheet as at the date of which Debt is to be determined; (ii) indebtedness secured by any mortgage, pledge, lien or security interest existing on property owned by the Person whose Debt is being determined, whether or not the indebtedness secured thereby shall have been assumed; and (iii) guaranties, endorsements (other than for purposes of collection in the ordinary course of business) and other contingent obligations in respect of, or to purchase or otherwise acquire indebtedness of others.

"Default" means any event which if continued uncured would, with notice or lapse of time or both, constitute an Event of Default

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended and as may be further amended from time to time, and the rules and regulations promulgated thereunder by any governmental agency or authority, as from time to time in effect.

"ERISA Affiliate" means, with respect to any person, any entity (whether or not incorporated) which is a member of a Controlled Group, within the meaning of Section 412(n) of the Internal Revenue Code, as amended from time to time, and the regulations promulgated and ruling issued thereunder, of which such person is a member.

"ERISA Event" means (i) a "reportable event," as such term is described in Section 4043 of ERISA (other than a "reportable event" not subject to the provision for a thirty (30) day notice to the PBGC), or an event described in Section 4068(f) of ERISA, or (ii) the withdrawal of Borrower or any ERISA Affiliate thereof from a multiple employer plan during a plan year in which it was a "substantial employer," as such term is defined in Section 4001(a)(2) of ERISA, or the incurrence of liability by Borrower or any ERISA Affiliate thereof under Section 4064 of ERISA upon the termination of a multiple employer plan, or (iii) the distribution of a notice of intent to terminate a Plan pursuant to Section 4041 (a)(2) of ERISA or the treatment of a plan amendment as a termination under Section 4041 of ERISA, or (iv) the institution of proceedings to terminate a Plan by the PBGC under Section 4042 of ERISA, or (v) any other event or condition which is reasonably likely to constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Plan.

"Eurodollar Interbank Rate" means, for each Business Day, the offered rate for deposits in United States Dollars (rounded upwards, if necessary, to the nearest 1/16th of one percent), as reported on the Reuters Screen LIBO Page for such Business Day for delivery of such deposits two (2) Business Days later for an Interest Period of one (1) month. If at least two rates appear on the Reuters Screen LIBO Page, the rate for such Interest Period shall be the arithmetic mean of such rates (rounded as provided above). If fewer than two rates appear, the Lender may, at its discretion, determine the rate based on rates offered to the Lender for United States Dollar deposits in the interbank Eurodollar market.

"Reuters Screen LIBO Page" means the display designated as page "LIBO" on the Reuter Monitor Money Rates Service (or such other page as may replace the LIBO Page on that service for the purpose of displaying London interbank offered rates of major banks for United States Dollar deposits).

"Eurodollar Rate" means a per annum rate of interest equal to the Eurodollar Rate (Reserve Adjusted) plus two and one-half percent (2.5011/o).

"Eurodollar Rate (Reserved Adjusted)": A rate per annum (rounded upward, if necessary, to the nearest 1/16th of one percent) calculated for each Business Day in accordance with the following formula, which shall continue in effect until the next succeeding Business Day:

$$ERRA = \frac{\text{Eurodollar Interbank Rate}}{1.00 - ERR}$$

In such formula, "ERR" means "Eurodollar Reserve Rate" and "ERRA" means "Eurodollar Rate (Reserve Adjusted)," in each instance determined by the Lender for the applicable Interest Period. The Lender's determination of all such rates for any Interest Period shall be conclusive in the absence of manifest error.

"Eurodollar Reserve Rate": A percentage, determined for each Business Day, equal to the daily average during such Interest Period of the aggregate maximum reserve requirements (including all basic, supplemental, marginal, and other reserves), as specified under Regulation D of the Federal Reserve Board, or any other applicable regulation that prescribes reserve requirements applicable to Eurocurrency liabilities (as presently defined in Regulation D) or applicable to extensions of credit by the Lender the rate of interest on which is determined with regard to rates applicable to Eurocurrency liabilities. Without limiting the generality of the foregoing, the Eurocurrency Reserve Requirement shall reflect any reserves required to be maintained by the Lender against (i) any category of liabilities that includes deposits by reference to which the Eurodollar Rate is to be determined, or (ii) any category of extensions of credit or other assets that includes the Revolving Credit Loan.

"Event of Default" means any event of default described in Section 8.1 hereof.

"GAAP" means the generally accepted accounting principles in the United States in effect from time to time including, but not limited to, Financial Accounting Standards Board (FASB) Standards and Interpretations, Accounting Principles Board (APB) Opinions and Interpretations, Committee on Accounting Procedure (CAP) Accounting Research Bulletins, and certain other accounting principles which have substantial authoritative support.

"Interest Period": Except as otherwise indicated, a period commencing on a Business Day and continuing until the following Business Day but not to extend beyond the Maturity of the Revolving Credit Note.

"Lender" means First Bank National Association, a national banking association, its successors and assigns:

"Letter of Credit" means any letter of credit issued by the Lender for the account of the Borrower, together with all amendments, modifications, replacements or restatements thereof.

"Lein" means any lien, security interest, pledge, mortgage, statutory or tax lien, or other encumbrance of any kind whatsoever (including without limitation, the lien or retained security title of a conditional vendor), whether arising under a security instrument or as a matter of law, judicial process or otherwise or by an agreement of the Borrower to grant any lien or security interest or to pledge, mortgage or otherwise encumber any of its assets.

"Loan Documents" means this Credit Agreement, the Notes and such other documents as the Lender may reasonably require as security for, or otherwise executed in connection with, any loan hereunder, all as originally executed and as may be amended, modified or supplemented from time to time by written agreement between the parties thereto.

"Material Adverse Occurrence" means any occurrence which materially adversely affects the present or prospective financial condition or operations of the Borrower, or which impairs, or may impair the ability of the Borrower to perform its obligations under the Loan Documents.

"Maturity" of the Revolving Credit Note means the earlier of (a) the date on which the Revolving Credit Note becomes due and payable upon the occurrence of an Event of Default; or (b) the Termination Date.

"Note(s)" means the Revolving Credit Note and any and all promissory notes and other evidences of indebtedness and repayment obligations of the Borrower to the Lender delivered in connection with a Letter of Credit, in each case as originally executed and as may be amended, modified, restated or replaced pursuant to written agreement signed by the Lender.

"Person" means any natural person, corporation, firm, association, government, governmental agency or any other entity, whether acting in an individual fiduciary or other capacity.

"Reference Rate" means the rate of interest established and publicly announced by the Lender from time to time as its "reference rate". The Lender may lend to its customers at rates that are at, above or below the Reference Rate.

"Regulatory Change" means any change after the date hereof in any (or the adoption after the date hereof of any new) (a) Federal or state law or foreign law applying to the Lender, or (b) regulation, interpretation, directive or request (whether or not having the force of law) applying or in the reasonable opinion of the Lender applicable to, the Lender of any court or governmental authority charged with the interpretation or administration of any law referred to in clause (a) of this definition or of any fiscal monetary, or other authority having jurisdiction over the Lender.

"Revolving Credit Commitment" means the sum of One Million and No/100 Dollars ($1,000,000.00) or the Lender's obligation to extend Advances to the Borrower under Section 2, as the context may require.

"Revolving Credit Loan" means, at any date, the aggregate amount of all Advances made by the Lender to the Borrower pursuant to Section 2 hereof.

"Revolving Credit Note" means the Revolving Credit Note of even date herewith in the original principal amount of One Million and No/100 Dollars ($1,000,000.00) made by the Borrower payable to the order of the Lender, together with all extensions, renewals, modifications, substitutions and changes in form thereof effected by written agreement between the Borrower and the Lender.

"Subsidiary" means any corporation of which more than fifty percent (50%) of the outstanding capital stock having ordinary voting power to elect a majority of the board of directors of such corporation (irrespective of whether, at the time, stock of any other class or classes of such corporation shall have or might have voting power by reason of the happening of any contingency) is at the time, directly or indirectly, owned by the Borrower and/or one or more Subsidiary or Affiliate.

"Tangible Net Worth" shall have the meaning ascribed to such term under GAAP (and shall be reduced by all proper reserves) except that in no event shall it include any receivables due from officers, directors, shareholders, partners, or entities affiliated with the Borrower, any leasehold improvements, patents, copyrights, or trademarks, any goodwill, or any organizational costs, nor shall it include any prepaid expenses or any investment by the Borrower in Natus, LLC.

"Termination Date" means the earlier of (a) January 1, 1997; or (b) the date upon which the obligation of the Lender to make Advances is terminated pursuant to Section 2.8.

"Working Capital" means, as of any date of determination the Borrower's Current Assets minus its Current Liabilities.

2. THE REVOLVING CREDIT LOAN

2.1. Commitment for Revolving Credit. Subject to the Conditions of Lending set forth in Section 4 hereof and as long as no Event of Default has occurred hereunder, the Lender agrees to make Advances to the Borrower from time to time from the date of this Credit Agreement through the Termination Date, provided, however, that the Lender shall not be obligated -to make any Advance, if after giving effect to such Advance, the aggregate outstanding principal amount of all Advances would exceed the Revolving Credit Commitment. Within the limits set forth above, the Borrower may borrow, repay and reborrow amounts under the Revolving Credit Note.

2.2. Purpose of Loan/Use of Proceeds. The Borrower will use the proceeds of any Advance hereunder for the Borrower's general corporate purposes.

2.3. The Revolving Credit Note. All Advances shall be evidenced by, and the Borrower shall repay such Advances to the Lender, in accordance with, the terms of the Revolving Credit Note; including without limitation the provision of the Revolving Credit Note that the principal amount payable thereunder at any time shall not exceed the then unpaid principal amount of all Advances made by the Lender.

2.4. Records of Advances and Proceeds. The Borrower hereby irrevocably authorizes the Lender to make or cause to be made, at or about the time each Advance is made by the Lender, an appropriate notation on the Lender's records of the principal amount of such Advance and the Lender shall make or

cause to be made, on or about the time a payment of any principal or interest of the Revolving Credit Note is received an appropriate notation of such payment on its records. The aggregate amount of all unpaid Advances set forth on the records of the Lender shall be rebuttable presumptive evidence of the principal amount owing and unpaid on the Revolving Credit Note.

2.5. Interest on the Revolving Credit Note.

(a) The Borrower agrees to pay interest on the outstanding principal amount of the Revolving Credit Note from the date thereof until paid in full at the Eurodollar Rate, adjusted each Business Day; provided, however, that upon the occurrence and during the continuation of an Event of Default the Borrower agrees to pay interest on the outstanding principal amount of the Revolving Credit Note at a rate per annum equal to the greater of (a) two percent (2.00%) in excess of the rate applicable to the unpaid principal amount immediately before such Event of Default; or (b) two percent (2.00%) in excess of the Reference Rate in effect from time to time.

(b) Interest accrued on the Revolving Credit Note through Maturity shall be payable on the first day of each calendar month, commencing June 1, 1996 and at Maturity. Interest accrued after Maturity shall be payable upon demand.

(c) No provision of this Credit Agreement or the Revolving Credit Note shall require the payment or permit the collection of interest in excess of the rate permitted by applicable law.

(d) All computation of interest on the outstanding principal amount of the Revolving Credit Note shall be computed on the basis of a year comprised of 360 days, but charged for the actual number of days elapsed. Each change in the interest rate payable on the Revolving Credit Note due to a change in the Eurodollar Interbank Rate shall take place simultaneously with the corresponding change in such rate.

2.6. Manner of Borrowing. The Borrower shall give the Lender written or telephonic notice of each requested Advance by not later than 1:00 p.m. (Minneapolis time) on the date such Advance is to be made. Each Advance shall be deposited to the Borrower's account no. 1-801-2060-0150 with the Lender.

2.7. Payments. Payments and prepayments of principal of, and interest on, the Revolving Credit Note and all fees, expenses and other obligations under this Credit Agreement and the other Loan Documents shall be made without set-off or counterclaim in immediately available funds not later than 3:00 p.m., Minneapolis time, on the dates due at the office of the Lender in Minneapolis, Minnesota indicated on the first page of this Credit Agreement. Funds received on any day after such time shall be deemed to have been received on the next Business Day. Whenever any payment to be made hereunder or on the Revolving Credit Note shall be stated to be due on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and such extension of time shall be included in the computation of any interest or fees. Notwithstanding the foregoing, the Borrower authorizes the Lender to charge from time to time against the Borrower's account no. 1-801-2060-0150 with the Lender any payments when due.

2.8. Termination. The obligation of the Lender to make Advances shall terminate:

(a) Upon receipt by the Lender of three (3) days' written notice of termination from the Borrower given at any time when no amount is outstanding under the Revolving Credit Note;

(b) Immediately and without further action upon the occurrence of an Event of Default of the nature referred to in

Subsection 8.1(c) or

(c) Immediately when any Event of Default (other than of the nature specified in Subsection 8.I c shall have occurred and be continuing and either (i) the Lender shall have demanded payment of the Revolving Credit Note or (ii) the Lender shall so elect to terminate its obligation to make Advances by giving notice to Borrower.

3. ADDITIONAL PROVISIONS REGARDING EURODOLLAR RATE

3.1. Increased Costs. If, as a result of any law, rule, regulation, treaty or directive, or any change therein or in the interpretation or administration thereof or compliance by the Lender with any request or directive (whether or not having the force of law) from any court, central bank, governmental authority, agency or instrumentality, or comparable agency:

(a) any tax, duty or other charge with respect to any of the loans under this Credit Agreement ("Loans"), the Notes or the Revolving Credit Commitment is imposed, modified or deemed applicable, or the basis of taxation of payments to the Lender of interest or principal of the Loans or of any fees with respect to the Revolving Credit Commitment ("Commitment Fees") (other than taxes imposed on the overall net income of the Lender by the jurisdiction in which the Lender has its principal office) is changed;

(b) any reserve, special deposit, special assessment or similar requirement against assets of, deposits with or for the account of, or credit extended by, the Lender is imposed, modified or deemed applicable;

(c) any increase in the amount of capital required or expected to be maintained by the Lender or any Person controlling the Lender is imposed, modified or deemed applicable; or

(d) any other condition affecting this Credit Agreement or the Revolving Credit Commitment is imposed on the Lender or the relevant funding markets;

and the Lender determines that, by reason thereof, the cost to the Lender of making or maintaining the Loans or the Revolving Credit Commitment is increased, or the amount of any sum receivable by the Lender hereunder or under a Note in respect of any Loan is reduced;

then, the Company shall pay to the Lender upon demand such additional amount or amounts as will compensate the Lender (or the controlling Person in the instance of (c) above) for such additional costs or reduction (provided that the Lender has not been compensated for such additional cost or reduction in the calculation of the Eurodollar Reserve Rate). Determinations by the Lender for purposes of this section of the additional amounts required to compensate the Lender shall be conclusive in the absence of manifest error. In determining such amounts, the Lender may use any reasonable averaging, attribution and allocation methods.

3.2. Deposits Unavailable or Interest Rate Unascertainable or Inadequate: Impracticability. If the Lender determines (which determination shall be conclusive and binding on the parties hereto) that:

(a) deposits of the necessary amount for the relevant Interest Period for any Advance are not available to the Lender in the relevant markets or that, by reason of circumstances affecting such market, adequate and reasonable means do not exist for ascertaining the Eurodollar Rate for such Interest Period;

(b) the Eurodollar Rate (Reserve Adjusted) will not adequately and fairly reflect the cost to the Lender of making or funding Advances for a relevant Interest Period; or

(c) the making or funding of Advances to bear interest at the

Eurodollar Rate has become impracticable as a result of any event occurring after the date of this Credit Agreement which, in the opinion of the Lender, materially and adversely affects such Advances or the Lender's commitment to make such Advances or the relevant market;

the Lender shall promptly give notice of such determination to the Company, and from and after such notice interest shall accrue on all then-outstanding and future Advances at one or more alternate rates of interest reasonably determined by the Lender.

3.3. Changes in Law Rendering Use of Eurodollar Rate Unlawful. If at any time due to the adoption of any law, rule, regulation, treaty or directive, or any change therein or in the-interpretation -or administration thereof by any court, central bank, governmental authority, agency or instrumentality, or comparable agency charged with the interpretation or administration thereof, or for any other reason arising subsequent to the date of this Credit Agreement, it shall become unlawful or impossible for the Lender to apply the Eurodollar Rate to obligations of the Company, the obligation of the Lender to apply such rate shall, upon the happening of such event, forthwith be suspended for the duration of such illegality or impossibility and, from and after such time interest shall accrue on then-outstanding and future Advances at one or more alternate rates of interest reasonably determined by the Lender.

3.4. Discretion of the Lender as to Manner of Funding. Notwithstanding any provision of this Credit Agreement to the contrary, the Lender shall be entitled to fund and maintain its funding of all or any part of the Loans in any manner it elects; it being understood, however, that for purposes of this Credit Agreement, all determinations hereunder shall be made as if the Lender had actually funded and maintained each Advance through the purchase of deposits having a term corresponding to such Interest Period and bearing an interest rate equal to the Eurodollar Interbank Rate for such Interest period (whether or not the Lender shall have granted any participations in such Advances).

4. CONDITIONS OF LENDING

4.1. Conditions Precedent. This Credit Agreement and the Lender's obligations hereunder are subject to receipt by the Lender of the following, each to be in form and substance satisfactory to the Lender, unless the Lender waives receipt of any of the following in writing:

(a) This Credit Agreement and the Revolving Credit Note each appropriately completed and duly executed by the Borrower;

(b) A current UCC secured transaction search, federal and state tax lien search, judgment and bankruptcy search, reflecting results satisfactory to the Lender, on the Borrower from the appropriate filing offices as required by the Lender,

(c) A Certificate of Good Standing for the Borrower issued by the Secretary of State of Minnesota;

(d) A copy of the Borrower's Bylaws, together with all amendments, certified by the Secretary of the Borrower to be a true and correct copy thereof;

(e) A copy of the Articles of Incorporation of the Borrower, together with all amendments, certified by the Secretary of State of the state of the Borrower's incorporation to be a true and correct copy thereof;

(f) A copy of the resolutions of the Board of Directors of the Borrower authorizing or ratifying the transactions contemplated hereby, and the execution, delivery and performance of the Loan Documents, and designating the officers authorized to execute the Loan Documents to which the Borrower is a party and to perform the obligations of the Borrower thereunder,

(g) A certificate of the Secretary of the Borrower certifying

the names of the officers authorized to execute the Loan Documents, together with a sample of the true signature of each such officer; and

(h) Such other documents, information and actions as the Lender may reasonably request.

4.2. Conditions Precedent to all Advances. The obligation of the Lender to make any Advance hereunder, including the initial Advance, is subject to the satisfaction of each of the following, unless waived in writing by the Lender:

(a) The representations and warranties set forth in Section 5 are true and correct in all material respects on the date hereof and on the date of any Advance.

(b) No Default or Event of Default shall have occurred and be continuing.

(c) No litigation, arbitration or governmental investigation or proceeding shall be pending, or, to the knowledge of the Borrower, threatened, against the Borrower or affecting the business or operations of the Borrower which was not previously disclosed to the Lender and which, if determined adversely to the Borrower, would have a material adverse effect on the operation or financial condition of the Borrower.

(d) No Default or Event of Default shall result from the making of any such Advance.

(e) No Material Adverse Occurrence shall have occurred and be continuing.

5. REPRESENTATIONS AND WARRANTIES

The Borrower represents and warrants to the Lender as follows:

5.1. Organization, etc. The Borrower is corporation validly organized and existing and in good standing under the laws of the State of Minnesota, has full power and authority to own its property and conduct its business substantially as presently conducted by it and is duly qualified to do business and is in good standing as a foreign corporation in each other jurisdiction where the nature of its business makes such qualification necessary. The Borrower has full power and authority to enter into and perform its obligations under the Loan Documents and to obtain the loans and Advances hereunder.

5.2. Due Authorization. The execution, delivery and performance by the Borrower of the Loan Documents have been duly authorized by all necessary corporate action, do not require any approval or consent of, or any registration, qualification or filing with, any governmental agency or authority or any approval or consent of any other Person (including, without limitation, any stockholder), do not and will not conflict with, result in any violation of or constitute any default under, any provision of the Borrower's Articles of Incorporation or Bylaws, any agreement binding on or applicable to the Borrower or any of its property, or any law or governmental regulation or court decree or order, binding upon or applicable to the Borrower or of any of its property and will not result in the creation or imposition of any Lien on any of its property pursuant to the provisions of any agreement binding on or applicable to the Borrower or any of its property except pursuant to the Loan Documents.

5.3. Validity of the Loan Documents. The Loan Documents to which the Borrower is a party are the legal, valid and binding obligations of the Borrower and are enforceable in accordance with their terms, subject only to bankruptcy, insolvency, reorganization, moratorium or similar laws, rulings or decisions at the time in effect affecting the enforceability of rights of creditors generally and to general equitable principles which may limit the right to obtain equitable remedies.

5.4. Financial Information. The financial statements of the Borrower furnished to the Lender have been and will be prepared in accordance with GAAP consistently applied by the Borrower and present fairly the financial condition of the Borrower as of the dates thereof and for the periods covered thereby. The

Borrower is not aware of any contingent liabilities or obligations which would, upon becoming non-contingent liabilities or obligations, be a Material Adverse Occurrence. Since the date of the most recent such statements, neither the condition (financial or otherwise), the business nor the properties of the Borrower have been materially and adversely affected in any way.

5.5. Litigation, Other Proceedings. Except as previously disclosed to and approved of in writing by the Lender, there is no action, suit or proceeding at law or equity, or before or by any governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, pending or, to the knowledge of the Borrower, threatened, against the Borrower or any of its property, which, if determined adversely would be a Material Adverse Occurrence; and the Borrower is not in default with respect to any final judgment, writ, injunction, decree, rule or regulation of any court or governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, where such default would be a Material Adverse Occurrence.

5.6. Title to Assets. Except for Liens permitted by Section 7.2, the Borrower has good and marketable title to all of its assets, real and personal.

5.7. Guarantees and Indebtedness. Except as disclosed on financial statements of the Borrower furnished to the Lender, the Borrower is not a party to any contract of guaranty or suretyship and none of its assets is subject to any contract of that nature and the Borrower is not indebted to any other party, except the Lender.

5.8. Margin Stock. No part of any loan or Advance hereunder shall be used at any time by the Borrower to purchase or carry margin stock (within the meaning of Regulation U promulgated by the Board of Governors of the Federal Reserve System) or to extend credit to others for the purpose of purchasing or carrying any margin stock. The Borrower is not engaged principally, or as one of its important activities, in the business of extending credit for the purposes of purchasing or carrying any such margin stock. No part of the proceeds of any loan or Advance hereunder will be used by the Borrower for any purpose which violates, or which is inconsistent with, any regulations promulgated by the Board of Governors of the Federal Reserve System.

5.9. Taxes. The Borrower has filed all federal, state and other income tax returns which are required to be filed through the date of this Credit Agreement and has paid all taxes as shown on said returns, and all taxes due or payable without returns and all assessments received to the extent such taxes and assessments have become due. All tax liabilities of the Borrower are adequately provided for on its books, including interest and penalties. No income tax liability of a material nature has been asserted by taxing authorities for taxes in excess of those already paid. The Borrower has made all required withholding deposits.

5.10. Accuracy of Information. All factual information furnished by or on behalf of the Borrower to the Lender for purposes of or in connection with this Credit Agreement or any transaction contemplated by this Credit Agreement is, and all other such factual information furnished by or on behalf of the Borrower to the Lender in the future, will be true and accurate in every material respect on the date as of which such information is dated or certified. No such information contains any material misstatement of fact or omits any material fact or any fact necessary to prevent such information from being misleading.

5.11. Material Agreements. The Borrower is not a party to any agreement or instrument or subject to any restriction that materially and adversely affects its business, property or assets, operations or condition (financial or otherwise).

5.12. Defaults. The Borrower is not in default in the performance, observance or fulfillment of any of the obligations, covenants or conditions contained in any: (a) agreement to which such entity is a party, which default might have a material adverse effect on the business, properties or assets, operations, or condition (financial or otherwise) of the Borrower, or (b) instrument evidencing any indebtedness or under any agreement relating to such indebtedness.

5.13. ERISA. (a) No Reportable Event has occurred and is continuing with respect to any Plan; (b) the Pension Benefit Guaranty Corporation or any successor entity has not instituted proceedings to terminate any Plan; and (c)

each Plan of the Borrower has been maintained and funded in all material respects in accordance with its terms and with ERISA. All undefined capitalized terms used in this Section shall have the meanings ascribed to them in ERISA.

5.14. Financial Status. The Borrower is not insolvent (as such term is defined in Section 101(29) of the United States Bankruptcy Code of 1978, as amended or Minnesota Statutes Section 513.42, as amended) and will not be rendered insolvent (as such term is defined in Section 10 1(29) of the United States Bankruptcy Code of 1978, as amended or Minnesota Statutes Section 513.42, as amended) by execution of this Credit Agreement or any other of the Loan Documents, or consummation of the transactions contemplated thereby.

5.15. Survival of Representations. All representations and warranties contained in this Section 5 shall survive the delivery of the Notes and the making of the loans and Advances evidenced thereby and any investigation at any time made by or on behalf of Lender shall not diminish its rights to rely thereon.

6. AFFIRMATIVE COVENANTS

As long as there remains any amount outstanding under the Notes or the Lender has any obligation to make Advances under the Revolving Loan Commitment, the Borrower shall, unless waived in writing by the Lender:

6.1. Financial Statements and Reports. Furnish to the Lender, at the times set forth below, the following financial statements, reports and information:

(a) As soon as available, but in any event within one hundred twenty (120) days after each fiscal year end, audited financial statements of the Borrower including without limitation a balance sheet, income statement and sources of income certified by certified public accountants satisfactory to the Lender to have been prepared in accordance with GAAP consistently applied;

(b) As soon as available but in any event within one hundred twenty (120) days after each fiscal year end a copy of the form IOK Report filed for such year by the Borrower with the Securities and Exchange Commission or other governmental entity;

(c) As soon as available, but in any event within sixty (60) days after the last day of each quarterly fiscal period a copy of the form IO-Q Report for such quarter filed by the Borrower with the Securities and Exchange Commission or other governmental entity; and

(d) Such other information concerning the business, operations and condition (financial or otherwise) of the Borrower as the Lender may reasonably request.

6.2. Maintenance of Corporate Existence. Maintain and preserve its corporate existence.

6.3. Taxes. Pay and discharge as the same shall become due and payable, all taxes, assessments and other governmental charges and levies against or on any of its property, as well as claims of any kind which, if unpaid, might become a Lien upon any of its properties, unless such tax, levy, charge assessment or Lien is being contested in good faith by the Borrower and is supported by an adequate book reserve. The Borrower shall make all required withholding deposits.

6.4. Notices. As soon as practicable, give notice to the Lender of:

(a) The commencement of any litigation relating to the Borrower involving claimed damages in excess of $100,000.00 or relating to the transactions contemplated by this Credit Agreement;

(b) The commencement of any material arbitration or governmental proceeding or investigation not previously disclosed to the Lender which has been instituted or, to the knowledge of the

Borrower, is threatened against the Borrower or its property which, if determined adversely to the Borrower, would have a material adverse effect on the business, operations or condition (financial or otherwise) of the Borrower,

(c) Any Reportable Event or "prohibited transaction" or the imposition of a Withdrawal Liability, within the meaning of ERISA, in connection with any Plan and, when known, any action taken by the Internal Revenue Service, Department of Labor or Pension Benefit Guaranty Corporation with respect thereto, and any adverse development which occurs in any litigation, arbitration or governmental investigation or proceeding previously disclosed to the Lender which if determined adversely to the Borrower would constitute a Material Adverse Occurrence; and

(d) Any Default or Event of Default under this Credit Agreement.

6.5. Compliance with Laws – Carry on its business activities in substantial compliance with all applicable federal or state laws and all applicable rules, regulations and orders of all governmental bodies and offices having power to regulate or supervise its business activities. The Borrower shall maintian all material rights, liens, franchises, permits, certificates of compliance or grants of authority required in the conduct of its business.

6.6. Books and Records. Keep books and records reflecting all of its business affairs and transactions in accordance with GAAP consistently applied and permit the Lender, and its representatives, at reasonable times and intervals, to visit all of its offices, discuss its financial matters with officers of the Borrower and its independent public accountants (and by this provision the Borrower authorizes its independent public accountants to participate in such discussions) and examine any of its books and other corporate records.

6.7. Insurance. The Borrower shall keep its business adequately insured and maintain the insurance coverages required under any document securing the Notes or this Credit Agreement.

6.8. Conduct of Business. Continue to engage primarily in the business being conducted on the date of this Credit Agreement.

6.9. Working Capital. Maintain at all times Working Capital of not less than Two Million and No/I00 Dollars ($2,000,000.00).

6.10. Tangible Net Worth. Maintain at all times Tangible Net Worth in an amount not less than Eight Million Eight Hundred Fifty Thousand and No/100 Dollars ($8,850,000.00).

6.11. Current Ratio. Maintain at all times a Current Ratio of not less than 2.5 to 1.0

6.12. Debt to Tangible Net Worth Ratio:. Maintain at all times a ratio of its Debt to its Tangible Net Worth of not more than .70 to 1.0

6.13. Zero Balance. Maintain a zero balance under the Revolving Credit Note for at least thirty (30) days during the term thereof.

6.14. Further Assurances. The Borrower agrees upon reasonable request by the Lender to execute and deliver such further instruments, deeds and assurances, and do such further acts as may be necessary or proper to carry out more effectively the purposes of this Credit Agreement and the other Loan Documents.

6.15. ERISA Compliance. Comply at all times with all applicable provisions of ERISA and the regulations and published interpretations thereunder.

6.16. Letters of Credit. The Borrower agrees that if it wishes from time to time to have the Lender issue for the Borrower's account one or more Letters of Credit, the Lender shall only be obligated to issue any such Letter of Credit upon completion of all applications, agreements for repayment and other documentation deemed necessary by the Lender for such Letter of Credit in accordance with its standard practices. The Borrower further agrees that (i) any

repayment agreement or other evidence of the Borrower's obligation to repay amounts outstanding under a Letter of Credit will be deemed one of the "Notes" for purposes of this Credit Agreement; (ii) the Borrower will pay to the Lender in connection with Letters of Credit all fees and costs in accordance with the Lender's customary and standard practices for letters of credit of the same type and amount and interest accrued on amounts advanced thereunder at the rate or rates described in the documents executed in connection with each such Letter of Credit; and (iii) no Letter of Credit shall expire later than the maturity date of the Revolving Credit Note stated thereon.

7. NEGATIVE COVENANTS

As long as there remains any amount outstanding under the Notes or the Lender has any obligation to make Advances under the Revolving Loan Commitment, the Borrower shall not, unless waived in writing by the Lender:

7.1. Consolidation Merger, Sale of Assets- Acquisitions. Consolidate with or merge into or with any other entity; or sell (other than sales of inventory in the ordinary course of business), transfer, lease or otherwise dispose of all or a substantial part of its assets; or acquire a substantial interest in another Person either through the purchase of all or substantially all of the assets of that Person or the purchase of a controlling equity interest in that Person.

7.2. Liens. Create, incur, assume or suffer to exist any Lien or any of its property, real or personal, except (a) Liens in favor of the Lender, (b) Liens disclosed to and approved of in writing by the Lender, (c) Liens for current taxes and assessments which are not yet due and payable; and (d) purchase money security interests to secure the indebtedness permitted under Section 7.3(d) below.

7.3. Additional Indebtedness. Create, incur, assume or suffer to exist any indebtedness except: (a) indebtedness in favor of the Lender, (b) current liabilities incurred in the ordinary course of business; (c) indebtedness existing on the date of this Credit Agreement and disclosed to and approved of in writing by the Lender; and (d) purchase money indebtedness incurred in connection with the acquisition of fixed assets not to exceed $250,000.00 in the aggregate during any fiscal year of the Borrower.

7.4. Guaranties. Assume, guarantee, endorse or otherwise become liable in connection with the indebtedness of any other person or entity except endorsements of negotiable instruments for deposit or collection in the ordinary course of business.

7.5. Change in Ownership. Permit a material change in the ownership or management of the Borrower as in effect on the date of this Credit Agreement.

8. EVENTS OF DEFAULT AND REMEDIES

8.1. Events of Default. The term "Event of Default" shall mean any of the following events:

(a) The Borrower shall default in the payment when due, or if payable on demand, upon demand, of any principal or interest on any of the Notes; or

(b) The Borrower shall default (other than a default in payment under subsection (a) above) in the due performance and observance of any of the covenants contained in any of the Loan Documents and such default shall continue unremedied for a period of fifteen (I5) days after notice from the Lender to the Borrower thereof; or

(c) The Borrower shall become insolvent or generally fail to pay or admit in writing its inability to pay its debts as they become due; or the Borrower shall apply for, consent to, or acquiesce in the appointment of a trustee, receiver or other custodian for itself or any of its property, or make a general assignment for the benefit of its creditors; or trustee, receiver or other custodian shall otherwise be appointed for the Borrower or any of its assets; or any bankruptcy, reorganization, debt arrangement, or other case or proceeding under any bankruptcy or insolvency law, or any

dissolution or liquidation proceeding shall be commenced by or against the Borrower or the Borrower shall take any corporate action to authorize, or in furtherance of, any of the foregoing; or

(d) Any judgments, writs, warrants of attachment, executions or similar process (not undisputedly covered by insurance) in an aggregate amount in excess of $25,000.00 shall be issued or levied against the Borrower or any of its assets and shall not be released, vacated or fully bonded prior to any sale and in any event within forty-five (45) days after its issue or levy; or

(e) Any garnishment summons, writ of attachment, or other legal paper referring to the Borrower or any Guarantor shall be served on the Lender, or

(f) Any representation or warranty set forth in this Credit Agreement or any other Loan Document shall be untrue in any material respect on the date as of which the facts set forth are stated or certified; or

(g) The occurrence of any Material Adverse Occurrence; or

(h) A Reportable Event (as defined under ERISA) shall have occurred.

8.2. Remedies. If an Event of Default described in Section 8.1(c) shall occur, the full unpaid balance of the Notes (outstanding balance plus accrued interest) and all other obligations of the Borrower to the Lender shall automatically be due and payable without declaration, notice, presentment, protest or demand of any kind (all of which are hereby expressly waived) and the obligation of the Lender to make additional Advances shall automatically terminate. If any other Event of Default shall occur and be continuing, the Lender may terminate its obligation to make additional Advances and may declare the outstanding balance of the Notes and all other obligations of the Borrower to the Lender to be due and payable without further notice, presentment, protest or demand of any kind (all of which are hereby expressly waived), whereupon the full unpaid amount of Notes and all other obligations of the Borrower to the Lender shall become immediately due and payable. Upon any Event of Default, the Lender shall be entitled to exercise any and all rights and remedies available under any of the Loan Documents or otherwise available at law or in equity to collect Notes and all other obligations of the Borrower to the Lender and to realize upon or otherwise pursue any and all Collateral and other security (including without limitation any and all guarantees) for the loans under this Credit Agreement

9. MISCELLANEOUS

9.1. Waivers-Amendments. The provisions of the Loan Documents may from time to time be amended, modified, or waived, if such amendment, modification or waiver is in writing and signed by the Lender. No failure or delay on the part of the Lender or the holder(s) of the Notes in exercising any power or right under any of the Loan Documents shall operate as a waiver thereof, nor shall any single or partial exercise of any such power or right preclude any other or further exercise thereof or the exercise of any other power or right. No notice to or demand on the Borrower in any case shall entitle it to any notice or demand in similar or other circumstances.

9.2. Notices. All communications and notices provided under this Credit Agreement shall be in writing and addressed or delivered to the Borrower or the Lender at their respective addresses shown on the first page hereof, or to any party at such other address as may be designated by such party in a written notice to the other parties. Such notices shall be delivered by any of the following means: (i) mailing through the United States Postal Service, postage prepaid, by registered or certified mail, return receipt requested; (ii) delivery by reputable overnight delivery service including without limitation, and by way of example only: Federal Express, DHL, Airborne Express and Express Mail; or (iii) delivery by reputable private personal delivery service. Notices delivered in accordance with (i) above shall be deemed delivered the second Business Day after deposit in the mail; notices delivered in accordance with (ii) above shall be deemed delivered the first Business Day after delivery to the delivery service; and notices delivered in accordance with (iii) above shall

be deemed delivered the same Business Day as that specified by the notifying party to the delivery service.

9.3. Costs and Expenses. The Borrower agrees to pay all expenses for the preparation of this Credit Agreement, including exhibits, and any amendments to this Credit Agreement as may from time to time hereafter be required, and the reasonable attorneys fees and legal expenses of counsel for the Lender, from time to time incurred in connection with the preparation and execution of this Credit Agreement and any document relevant to this Credit Agreement, and amendments hereto or thereto, and the consideration of legal questions relevant hereto and thereto. The Borrower agrees to reimburse Lender upon demand for, all reasonable out-of-pocket expenses (including attorneys fees and legal expenses) in connection with the Lender's enforcement of the obligations of the Borrower hereunder or under the Note or any other of the Loan Documents, whether or not suit is commenced including, without limitation, attorneys fees, and legal expenses in connection with any appeal of a lower court's order or judgment The obligations of the Borrower under this Section 9.3 shall survive any termination of this Credit Agreement.

9.4. Interest Limitation. All agreements between the Borrower and the Lender are hereby expressly limited so that in no contingency or event whatsoever, whether by reason of acceleration of maturity of the indebtedness evidenced or secured thereby or otherwise, shall the rate of interest charged or agreed to be paid to the Lender for the use, forbearance, loaning or detention of such indebtedness exceed the maximum permissible interest rate under applicable law ("Maximum Rate"). If for any reason or in any circumstance whatsoever fulfillment of any provision of this Credit Agreement and/or the Notes, any document securing or executed in connection herewith or therewith, or any other agreement between the Borrower and the Lender, at any time shall require or permit the interest rate applied thereunder to exceed the Maximum Rate, then the interest rate shall automatically be reduced to the Maximum Rate, and if the Lender should ever receive interest at a rate that would exceed the Maximum Rate, the amount of interest received which would be in excess of the amount receivable after applying the Maximum Rate to the balance of the outstanding obligation shall be applied to the reduction of the principal balance of the outstanding obligation for which the amount was paid and not to the payment of interest thereunder. This provision shall control every other provision of any and all agreements between the Borrower and the Lender and shall also be binding upon and applicable to any subsequent holder of the Notes.

9.5. Severability. Any provision of this Credit Agreement or any other of the Loan Documents executed pursuant hereto which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such portion or unenforceability without invalidating the remaining provisions of this Credit Agreement or such Loan Document or affecting the validity or enforceability of such provisions in any other jurisdiction.

9.6. Cross-References. References in this Credit Agreement or in any other of the Loan Documents executed pursuant hereto to any Section are, unless otherwise specified, to such Section of this Credit Agreement or such Loan Document, as the case may be.

9.7. Headings. The various headings of this Credit Agreement or of any other of the Loan Documents executed pursuant hereto are inserted for convenience only and shall not affect the meaning or interpretation of this Credit Agreement or such Loan Document or any provisions hereof or thereof.

9.8. Governing Law: Venue, Each of the Loan Documents shall be deemed to be a contract made under and governed by the laws of the State of Minnesota. The Borrower hereby consents to the personal jurisdiction of the state and federal courts located in the State of Minnesota in connection with any controversy related to this Credit Agreement and any other of the Loan Documents, waives any argument that venue in such forums is not convenient and agrees that any litigation instigated by the Borrower against the Lender in connection herewith or therewith shall be venued in the federal or state court that has jurisdiction over matters arising in Minneapolis, Minnesota.

9.9. Successors and Assigns. This Credit Agreement shall be binding upon and shall inure to the benefit of the parities hereto and their respective successors and assigns, except that Borrower may not assign or transfer its rights hereunder without the prior written consent of Lender.

9.10. Recitals Incorporated. The recitals to this Credit Agreement

are incorporated into and constitute an integral part of this Credit Agreement

9.11. Multiple Counterparts. This Credit Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original and all of which shall constitute one and the same instrument.

9.12. Prior Loan Agreements Superseded, This Credit Agreement amends, restates, and supersedes in their entirety the Prior Loan Agreements and all obligations, liabilities and indebtedness of the Borrower incurred or arising thereunder shall be deemed to have been incurred and arising hereunder.

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

LECTEC CORPORATION,
a Minnesota corporation

By: /s/Erwin Templin

Its: Excecutve Vice President

FIRST BANK NATIONAL ASSOCIATION,
a national banking association

By: /s/Terri A. Deveau

Its: Vice President

ACKNOWLEDGMENTS

STATE OF MINNESOTA)
)
COUNTY OF HENNEPIN)

The foregoing instrument was acknowledged before me this 6th day of May 1996, by Erwin Templin, the Executive Vice President of LECTEC CORPORATION, a Minnesota corporation, on behalf of the corporation.

/s/Terri A. Deveau
Notary Public

Terri A. DeVeau
HENNEPIN COUNTY
My Commission Expires Jan. 31, 2000

STATE OF MINNESOTA)
)
COUNTY OF HENNEPIN)

The foregoing instrument was acknowledged before me this 6th day of May, 1996, by Terry A. DeVeau, the Vice President of FIRST BANK NATIONAL ASSOCIATION a national banking association, on behalf of the association.

/s/ Dawn M. Riegert
Notary Public

Dawn M. Reigert
Hennipin County
My Commission Expires Jan. 31. 2000

$1,000,000.00 *Minneapolis, Minnesota*

Due: January 1, 1997 *May 1, 1996*

REVOLVING CREDIT NOTE

1. LOAN AMOUNT AND INTEREST RATE. FOR VALUE RECEIVED, LECTEC CORPORATION, a Minnesota corporation ("Maker") promises to pay to the order of FIRST BANK NATIONAL ASSOCIATION, a national banking association ("Lender"), its successors and assigns, at its office at 300 Prairie Center Drive, Eden Prairie, Minnesota 55344, or such other place as the holder hereof may designate in writing from time to time, the principal sum of One Million and No/100 Dollars (S 1,000,000.00), or so much thereof as may be advanced from time to time pursuant to that certain Credit Agreement dated of even date herewith between the Maker and the Lender, as the same may be amended, modified, restated or replaced from time to time as agreed upon in writing by the Lender ("Credit Agreement"), in lawful money of the United States, together with interest from the date hereof on the unpaid balance hereof from time to time outstanding at rates per annum which shall be determined in accordance with the provisions of the Credit Agreement.

2. PAYMENT SCHEDULE. This Note shall be payable in the following manner

2.1 Accrued interest hereon shall be due and payable on the first day of each calendar month, commencing June 1, 1996, until all indebtedness evidenced hereby is paid in full. All outstanding principal and accrued and unpaid interest shall be due and payable on January 1, 1997.

2.2 Each payment made under this Note shall be applied, first, to the amount then due for any expenses, costs or other expenditures incurred by the Lender in connection with this Note and payable by the Maker, and then applied to any accrued interest then due under this Note, and any balance thereafter remaining shall be applied against principal outstanding under this Note.

2.3 Any payment due on any non-business day of the Lender shall be due upon (and interest shall accrue to) the next business day.

3. DEFAULT INTEREST RATE. Upon the occurrence and during the continuation of an Event of Default as defined in the Credit Agreement, the interest rate shall thereafter increase and shall be payable on the whole of the unpaid principal balance, interest and other charges at a rate equal to the lesser of (i) two percent (2.00%) per annum in excess of the rate of interest then in effect under the terms of this Note or (ii) two percent (2.00%) per annum plus the Reference Rate (as defined in the Credit Agreement) in effect from time to time. This provision shall not be deemed to excuse an Event of Default not be deemed a waiver of any other rights the Lender may have including the right to declare the entire unpaid principal and interest under this Note immediately due and payable.

4. CREDIT AGREEMENT. This Note is the Revolving Credit Note issued pursuant to the terms and provisions of the Credit Agreement and this Note and the holder hereof are entitled to all of the benefits provided for in the Credit Agreement, or referred to therein. Reference is made to the Credit Agreement for a statement of the terms and conditions under which this indebtedness was incurred and is to be repaid and under which the due date of this Note may be accelerated. The provisions of the Credit Agreement are hereby incorporated by reference with the same force and effect as if fully set forth herein.

5. DEFAULT AND ACCELERATION. If an Event of Default, as defined in the Credit Agreement or any other agreement made by any party in connection with this Note, shall occur, and/or if any portion of the indebtedness evidenced hereby is not paid when due, the Lender or other holder of this Note may,

without notice, demand, presentment for payment and/or notice of nonpayment, all of which Maker hereby expressly waives, declare the indebtedness evidenced hereby and all other indebtedness and obligations of the Maker to the Lender or holder hereof immediately due and payable and the Lender or other holder hereof may, without notice, immediately exercise any right of setoff and enforce any lien or security interest securing payment hereof. The foregoing shall be in addition to the rights of acceleration that may be provided in any loan agreement, security agreement, mortgage and/or other writing relating to the indebtedness evidenced hereby. If this Note is placed with any attorney(s) for collection upon any default, the Maker agrees to pay to the Lender or holder, its reasonable attorneys fees and all lawful costs and expenses of collection, whether or not a suit is commenced.

6. WAIVER, Time is of the essence. No delay or omission on the part of the Lender or other holder hereof in exercising any right or remedy hereunder shall operate as a waiver of such right or of any other right or remedy under this Note or any other document or agreement executed in connection herewith. All waivers by the Lender must be in writing to be effective and a waiver on any occasion shall not be construed as a bar to or a waiver of any similar right or remedy on a future occasion. The makers, endorsers, sureties, guarantors and all other persons liable for all or any part of the indebtedness evidenced by this Note jointly and severally waive presentment for payment, protest and notice of nonpayment. Such parties hereby consent without affecting their liability to any extension or alteration of the time or terms of payment hereon, any renewal, any release of all or any part of the security given for the payment hereof, any acceptance of additional security of any kind, and any release of, or resort to any party liable for payment hereof and such parties shall remain bound in the same capacities as prior thereto upon each such event.

7. SECURITY. As security for this Note, the Maker and any other party to this Note hereby grant to the Lender a security interest in any deposits or other sums at any time credited by or due from the Lender to any maker, endorser or guarantor hereof and any securities or other property of any maker, endorser or guarantor hereof in the possession of the lender or other holder of this Note. The Lender or other holder hereof may apply or set off such property deposits or other sums against the obligations hereunder at any time in case of makers, but only with respect to matured liabilities in the case of endorsers or guarantors.

8. JURISDICTION. This Note represents a loan negotiated, executed and to be performed in the State of Minnesota and shall be construed, interpreted and governed by the law of said state. The Maker hereby consents to the personal jurisdiction of the state and federal courts located in the State of Minnesota in connection with any controversy related to this Note, waives any argument that venue in such forums is not convenient and agrees that any litigation instigated by the Maker against the Lender in connection with this Note shall be venued in the federal or state court that has jurisdiction over matters arising in Minneapolis, Minnesota.

9. EXTENSION AND RENEWAL. This Note is issued in substitution for, but not in payment of, that certain promissory note of Maker dated January 2, 1996 in the original principal amount. of $1,000,000.00 payable to the order of the Lender and amounts outstanding thereunder shall hereafter be deemed outstanding hereunder.

10. INTEREST LIMITATION. All agreements between the Maker and the Lender are hereby expressly limited so that in no contingency or event whatsoever, whether by reason of acceleration of maturity of the indebtedness evidenced or secured thereby or otherwise, shall the rate of interest charged or agreed to be paid to the Lender for the use, forbearance, loaning or detention of such indebtedness exceed the maximum permissible interest rate under applicable law ("Maximum Rate"). If for any reason or in any circumstance whatsoever fulfillment of any provision of this Note, any document securing or executed in connection with this Note, or any other agreement between the Maker and the Lender, at any time shall require or permit the interest rate applied thereunder to exceed the Maximum Rate, then the interest rate shall automatically be reduced to the Maximum Rate, and if the Lender should ever receive interest at a rate that would exceed the Maximum Rate, the amount of interest received which would be in excess of the amount receivable after applying the Maximum Rate to the balance of the outstanding obligation shall be applied to the reduction of the principal balance of the outstanding obligation for which the amount was paid and not to the payment of interest thereunder. This provision shall control every other provision of any and all agreements

between the Maker and the Lender and shall also be binding upon and available to any subsequent holder of this Note.

IN WITNESS WHEREOF, the Maker has executed and delivered this Note to the Lender as of the day and year first above written.

LECTEC CORPORATION,
a Minnesota corporation

By /s/Erwin W. Templin

Its ExecutiveVice President

ACKNOWLEDGMENT

STATE OF MINNESOTA)
) SS.
COUNTY OF HENNEPIN)

The foregoing instrument was acknowledged before me this 6th day of May 1996, by Erwin Templin, the Ex. Vice President of LECTEC CORPORATION, a Minnesota corporation on behalf of the corporation.

/s/Terri DeVeau
Notary Public

WORKING CAPITAL LOAN AGREEMENT

THIS WORKING CAPITAL LOAN AGREEMENT ("Agreement") is dated as of the 5th day of September, 1995 and is by and between _____ ("Shareholder"), and Natus Corporation ("Natus"), a Minnesota Corporation, whose address is 4550 West 77th Street, Suite 300, Minneapolis, Minnesota 55435.

ARTICLE 1

SECTION 1.1. Subject to the terms of this Agreement, Shareholder agrees to loan to Natus (defined as "Loan") the amount $_____ Dollars ($_____). Natus shall execute and deliver to Shareholder a promissory note ("Note") in the amount of the Loan in a form substantially similar to the form attached hereto and labeled as Exhibit A. The Note shall mature on the Maturity Date.

SECTION 1.2. The principal balance of the Loan shall be paid in full no later than one year from the date hereof (defined as the "Maturity Date,'); provided, however, that the Loan may be paid in full or in part at any time prior to the Maturity Date.

SECTION 1.3. Interest on the Loan shall accrue at the rate of seven percent (7%) per annum from the date of the Loan. Interest on the Loan shall accrue on the basis of actual days lapsed in a year of 365 days and shall be paid on the Maturity Date.

SECTION 1.4. Unless otherwise agreed to by Shareholder, all payments of principal and interest required hereunder or under the Loan shall be made to Shareholder without offset deduction or counterclaim of any kind whatsoever on the date on which such payment is due. Interest on the principal amount of the Loan shall abate upon receipt of such amount by Shareholder. If payment under the Loan becomes due and payable on a day other than a business day, the due date thereof shall be extended to the next succeeding business day, and interest thereon shall be payable at the applicable rate during such extension.

SECTION 1.5. Natus may at any time, at its option, prepay the Loan, in whole or in part, without premium or penalty. All prepayments shall be applied first to accrued and unpaid interest under the Loan, then to principal.

SECTION 1.6. For purposes of this Agreement, the Maturity Date is September 5, 1996.

ARTICLE 2

SECTION 2.1. Any of the following events shall be an "Event of Default" under this Agreement:

a. If Natus shall default in the payment when due of principal or interest on the Loan or any other obligation payable by Natus hereunder as and when such payment or obligation is due and payable, provided that such default shall continue for a period of thirty (30) days from the date on which such payment was due; or

b. If Natus shall default in the due observance or performance of any other covenant, condition or agreement contained in this Agreement; or

c. If Natus shall:

i. Make an assignment for the benefit of creditors, or file a voluntary petition under any bankruptcy, reorganization or receivership laws, or if proceedings under any bankruptcy, reorganization or receivership law shall be instituted against Natus and not dismissed within thirty (30) days after its commencement; or

ii. Generally not pay its debts as such debts become due, or admit in writing its inability to pay its debts as they mature: or

iii. Become "insolvent, " as such term is defined in the

Bankruptcy Code, 11 U.S.C. Section 101 (3 1) .

SECTION 2.2. Upon the occurrence of an Event of Default and at any time thereafter, Shareholder may, at its option, and without notice, take any or all of the following actions:

a. Declare the Loan, and all other obligations of Natus to Shareholder to be forthwith due and payable in full, without presentment, demand, protest or other notice of any kind, all of which, to the extent permitted by applicable law, are hereby expressly waived; or

b. Take any and all action and pursue any and all remedies as may be permitted by this Agreement or by applicable law. In the event the Loan is referred to an attorney-at-law for collection after an Event of Default, then in addition to the principal and interest, Shareholder shall be entitled to collect all costs of collection, including but not limited to actual attorney's fees, incurred in connection with any of Shareholder's collection efforts, whether or not suit on this Loan is filed, and all such costs and expenses shall be payable on demand.

SECTION 2.3. The powers conferred on Shareholder by this Article 2 are solely to protect the interest of Shareholder, and shall not impose any duties on Shareholder to exercise any powers. The remedies herein provided are cumulative and not exclusive of any remedies provided by law.

ARTICLE 3

SECTION 3.1. Unless otherwise specified herein, all notices, requests, demands or other communications to or from the parties hereto shall be addressed to the address set forth herein. Any notice, demand or request so delivered shall constitute valid notice under this Agreement and shall be deemed to have been received (a) on the day of actual delivery in the case of personal delivery, (b) on the next business day after the date when sent in the case of delivery by a nationally-recognized overnight courier, (c) on the third business day after the date of deposit in the U.S. mail in the case of mailing or (d) in the case of a facsimile transmission on the day sent, if on a business day, or if not sent on a business day, on the next business day after the day sent. Any party hereto may from time to time by notice in writing served upon the other as aforesaid designate a different mailing address to which all such notices, demands or requests thereafter are to be addressed.

SECTION 3.2. None of the Shareholder's rights or interests under or in this Agreement, in the Note, or in the Stock Warrant Agreement described in Article 4 of this Agreement may be assigned.

SECTION 3.3. This Agreement may be executed in two or more counterparts, each of which shall constitute an original, but all of which taken together shall constitute one contract. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Minnesota.

SECTION 3.4. Neither any failure nor any delay on the part of Shareholder in exercising any right, power or privilege hereunder shall operate as a waiver thereof, nor shall a single or partial exercise thereof preclude any other or further exercise, or the exercise of any other right, power or privilege.

SECTION 3.5. No modification, amendment or waiver of any provision of this Agreement, nor consent to any departure by Natus therefrom, shall in any event be effective unless the same shall be in writing and signed by Shareholder, and then such waiver or consent shall be effective only in the specified instance and for the purpose for which given. No notice to or demand on Natus in any case shall entitle Natus to any other or further notice or demand in the same, similar or other circumstances.

SECTION 3.6. This Agreement shall become effective when it shall have been executed by Natus and Shareholder. In case one or more of the provisions contained in this Agreement should be invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained herein and therein shall not in any way be affected or impaired thereby.

SECTION 3.7. Article headings in this Agreement are included herein for convenience of reference only, and shall not constitute a part of this Agreement

for any other purpose.

SECTION 3.8. This is not a third-party beneficiary contract and nothing herein, express or implied, is intended or shall be construed to confer upon or to give to any person or corporation, other than the parties hereto, any right, remedy or claim under or by reason of this Agreement, and the covenants, stipulations and agreement contained herein are and shall be for the sole and exclusive benefit of the parties hereto, their successors and assigns.

SECTION 3.9. NATUS HEREBY REPRESENTS AND WARRANTS TO SHAREHOLDER THAT THE OBLIGATIONS EVIDENCED BY THIS AGREEMENT ARE STRICTLY AND EXCLUSIVELY FOR WORKING CAPITAL PURPOSES ONLY.

ARTICLE 4

SECTION 4.1. Subject to the terms of a Stock Warrant Agreement ("Warrant") in a form substantially similar to the form attached hereto and labeled as Exhibit B, Natus agrees to issue, for each full dollar of the Loan, a warrant to purchase one share of Natus Corporation common stock at the purchase price of one dollar ($1.00) per share of common stock.

SECTION 4.2. Unless otherwise sooner terminated, the term of the Warrant shall automatically expire on the Maturity Date of the Loan (defined as "Warrant Term").

SECTION 4.3. The Warrant may be exercised in full or in part at any time during the Warrant Term; provided, however, it is acknowledged and understood by the parties hereto that no fractional shares will be issued under the Warrant.

ACCORDINGLY, the parties hereto have caused this Agreement to be executed as of the date first written above.

NATUS CORPORATION	*SHAREHOLDER*
BY: Kathleen A. Billings	_____
	(Signature)
ITS: President	_____
	(Print Name)
DATE: September 5, 1995	_____
	Address
	_____
	City State Zip

Exhibit A

$ *Minneapolis, Minnesota*
September 5, 1995

NON-NEGOTIABLE PROMISSORY NOTE

FOR VALUE RECEIVED, the undersigned, Natus Corporation (hereinafter "Payor") , promises to pay to the order of _____ (hereinafter the "Holder") , in lawful money of the United States of America, the principal sum of $ Dollars ($_____) , together with interest on the unpaid balance of such amount at the rate of seven percent (7%) per annum.

This Note is referred to in that certain Working Capital Loan Agreement (the "Agreement") dated September 5, 1995 between the Payor and Holder. This Note is issued, is to be repaid, and may be accelerated under the terms and provisions of the Agreement. The Holder is entitled to all the benefits provided for in the Agreement, or referred to therein. The provisions of the Agreement are incorporated by reference herein with the same force and effect as if fully set forth herein.

On September 5 1996, all principal and interest hereunder shall be immediately due and payable in full. All or any part of the balance due hereunder may be prepaid at any time without penalty. All payments on this Note shall be applied first to the payment of accrued interest, and the balance shall be applied to principal.

The Holder may, at its option, record on this Note by appropriate notation the date and amount of each payment of principal made by the Payor. Each such entry shall be prima facie evidence of the amount outstanding hereunder; provided, however, that the failure by the Holder to make any such endorsement shall not affect the obligations of the Payor hereunder. Absent manifest error, this Note shall be conclusive evidence of the principal and interest due hereunder.

The Payor hereby waives presentment and demand for payment, notice of dishonor, protest and notice of protest, and agrees to pay all reasonable costs of collection, including reasonable attorneys, fees.

No failure to accelerate the debt evidenced hereby by reason of a default hereunder shall be construed to be a waiver of the right to insist upon prompt payment thereafter, or shall be deemed to be a novation of this Note, or as a reinstatement of the debt evidenced hereby, or as a waiver of such right of acceleration or any other right, or be construed so as to preclude the exercise of any right which the Holder may have, whether by the laws of the state governing this Note, by agreement, or otherwise.

This Note may not be changed orally, but only by an agreement in writing signed by the party against whom such agreement is sought to be enforced. This Note shall be governed by and construed in accordance with the laws of the State of Minnesota.

NATUS CORPORATION

By: _____
Its: _____

Exhibit B

WARRANT TO PURCHASE SHARES OF COMMON STOCK OF NATUS CORPORATION

For value received, _____("Investor"), is entitled to subscribe to and purchase from Natus Corporation, a Minnesota corporation (the "Company") , up to _____ ( ) fully paid and nonassessable shares of the Company's common stock at the price of One Dollar ($1.00) per share (the "warrant exercise price").

This warrant may be exercised by Investor at any time or from time to time after September 5, 1995 and prior to September 5, 1996. This warrant is subject to the following provisions, terms and conditions:

1. The rights represented by this warrant may be exercised by the holder hereof, in whole or in part, by written notice of exercise delivered to the Company at least twenty (20) days prior to the intended date of exercise and by the surrender of this warrant (properly endorsed if required) at the principal office of the Company and upon payment to it by cash, certified check or bank draft of the purchase price for such shares. The shares so purchased shall be deemed to be issued as of the close of business on the date on which this warrant has been so exercised by payment to the Company of the warrant exercise price. Certificates for the shares of stock so purchased shall be delivered to the holder within fifteen (15) days after the rights represented by this warrant shall have been so exercised, and, unless this warrant has expired, a new warrant representing the number of shares, if any, with respect to which this warrant has not been exercised shall also be delivered to the holder hereof within such time. No fractional shares shall be issued upon the exercise of this warrant.

2. The Company covenants and agrees that all shares that may be issued upon the exercise of the rights represented by this warrant shall, upon issuance, be duly authorized and issued, fully paid and nonassessable shares. The Company further covenants and agrees that during the period within which the rights represented by this warrant may be exercised, the Company will at all times have authorized, and reserved for the purpose of issue or transfer upon exercise of the subscription rights evidenced by this warrant, a sufficient number of shares of its common

stock to provide for the exercise of the rights represented by this warrant.

3. This warrant shall not entitle the holder hereof to any voting rights or other rights as a shareholder of the Company.

4. This warrant and all rights hereunder are not transferable, in whole or in part, without the express prior written consent of the Company, which consent may be withheld for any reason.

5. Neither this warrant nor any term hereof may be changed, waived, discharged or terminated orally, but only by an instrument in writing signed by the party against which enforcement of the change, waiver, discharge or termination is sought.

IN WITNESS WHEREOF, the Company has caused this warrant to be signed and delivered by a duly authorized officer as of the 5th day of September 5, 1995

Natus Corporation

By: _____

Its: _____

WARRANT EXERCISE
(To be signed only upon exercise of warrant)

*The undersigned, the holder of the foregoing warrant, hereby irrevocably elects to exercise the purchase right represented by such warrant for, and to purchase thereunder, the shares of common stock of Natus Corporation, to which such warrant relates and herewith makes payment of $ ** therefor in cash or by check and requests that the certificates for such shares be issued in the name of, and be delivered to whose address is set forth below the signature of the undersigned.*

Dated: _____

_____
(Signature)

_____
(Address)

WORKING CAPITAL LOAN AGREEMENT

THIS WORKING CAPITAL LOAN AGREEMENT (Agreement) is dated as of the 5th day of September, 1995 and is by and between LecTec Corporation ("Shareholder"), and Natus Corporation ("Natus"), a Minnesota Corporation, whose address is 4550 West 77th Street, Suite 300, Minneapolis, Minnesota 55435.

ARTICLE 1

SECTION 1.1. Subject to the terms of this Agreement, Shareholder agrees to loan to Natus (defined as "Loan") the amount $227,959.00 Dollars ($ 227,959.00) . Natus shall execute and deliver to Shareholder a promissory note ("Note") in the amount of the Loan in a form substantially similar to the form attached hereto and labeled as Exhibit A. The Note shall mature on the Maturity Date.

SECTION 1.2. The principal balance of the Loan shall be paid in full no later than one year from the date hereof (defined as the "Maturity Date,'); provided, however, that the Loan may be paid in full or in part at any time prior to the Maturity Date.

SECTION 1.3. Interest on the Loan shall accrue at the rate of seven percent (7%) per annum from the date of the Loan. Interest on the Loan shall accrue on the basis of actual days lapsed in a year of 365 days and shall be paid on the Maturity Date.

SECTION 1.4. Unless otherwise agreed to by Shareholder, all payments of principal and interest required hereunder or under the Loan shall be made to Shareholder without offset deduction or counterclaim of any kind whatsoever on the date on which such payment is due. Interest on the principal amount of the Loan shall abate upon receipt of such amount by Shareholder. If payment under the Loan becomes due and payable on a day other than a business day, the due date thereof shall be extended to the next succeeding business day, and interest thereon shall be payable at the applicable rate during such extension.

SECTION 1.5. Natus may at any time, at its option, prepay the Loan, in whole or in part, without premium or penalty. All prepayments shall be applied first to accrued and unpaid interest under the Loan, then to principal.

SECTION 1.6. For purposes of this Agreement, the Maturity Date is September 5, 1996.

ARTICLE 2

SECTION 2.1. Any of the following events shall be an "Event of Default" under this Agreement:

a. If Natus shall default in the payment when due of principal or interest on the Loan or any other obligation payable by Natus hereunder as and when such payment or obligation is due and payable, provided that such default shall continue for a period of thirty (30) days from the date on which such payment was due; or

b. If Natus shall default in the due observance or performance of any other covenant, condition or agreement contained in this Agreement; or

c. If Natus shall:

i. Make an assignment for the benefit of creditors, or file a voluntary petition under any bankruptcy, reorganization or receivership laws, or if proceedings under any bankruptcy, reorganization or receivership law shall be instituted against Natus and not dismissed within thirty (30) days after its commencement; or

ii. Generally not pay its debts as such debts become due, or admit in writing its inability to pay its debts as they mature: or

iii. Become "insolvent, " as such term is defined in the

Bankruptcy Code, 11 U.S.C. Section 101 (3 1).

SECTION 2.2. Upon the occurrence of an Event of Default and at any time thereafter, Shareholder may, at its option, and without notice, take any or all of the following actions:

a. Declare the Loan, and all other obligations of Natus to Shareholder to be forthwith due and payable in full, without presentment, demand, protest or other notice of any kind, all of which, to the extent permitted by applicable law, are hereby expressly waived; or

b. Take any and all action and pursue any and all remedies as may be permitted by this Agreement or by applicable law. In the event the Loan is referred to an attorney-at-law for collection after an Event of Default, then in addition to the principal and interest, Shareholder shall be entitled to collect all costs of collection, including but not limited to actual attorney's fees, incurred in connection with any of Shareholder's collection efforts, whether or not suit on this Loan is filed, and all such costs and expenses shall be payable on demand.

SECTION 2.3. The powers conferred on Shareholder by this Article 2 are solely to protect the interest of Shareholder, and shall not impose any duties on Shareholder to exercise any powers. The remedies herein provided are cumulative and not exclusive of any remedies provided by law.

ARTICLE 3

SECTION 3.1. Unless otherwise specified herein, all notices, requests, demands or other communications to or from the parties hereto shall be addressed to the address set forth herein. Any notice, demand or request so delivered shall constitute valid notice under this Agreement and shall be deemed to have been received (a) on the day of actual delivery in the case of personal delivery, (b) on the next business day after the date when sent in the case of delivery by a nationally-recognized overnight courier, (c) on the third business day after the date of deposit in the U.S. mail in the case of mailing or (d) in the case of a facsimile transmission on the day sent, if on a business day, or if not sent on a business day, on the next business day after the day sent. Any party hereto may from time to time by notice in writing served upon the other as aforesaid designate a different mailing address to which all such notices, demands or requests thereafter are to be addressed.

SECTION 3.2. None of the Shareholder's rights or interests under or in this Agreement, in the Note, or in the Stock Warrant Agreement described in Article 4 of this Agreement may be assigned.

SECTION 3.3. This Agreement may be executed in two or more counterparts, each of which shall constitute an original, but all of which taken together shall constitute one contract. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Minnesota.

SECTION 3.4. Neither any failure nor any delay on the part of Shareholder in exercising any right, power or privilege hereunder shall operate as a waiver thereof, nor shall a single or partial exercise thereof preclude any other or further exercise, or the exercise of any other right, power or privilege.

SECTION 3.5. No modification, amendment or waiver of any provision of this Agreement, nor consent to any departure by Natus therefrom, shall in any event be effective unless the same shall be in writing and signed by Shareholder, and then such waiver or consent shall be effective only in the specified instance and for the purpose for which given. No notice to or demand on Natus in any case shall entitle Natus to any other or further notice or demand in the same, similar or other circumstances.

SECTION 3.6. This Agreement shall become effective when it shall have been executed by Natus and Shareholder. In case one or more of the provisions contained in this Agreement should be invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained herein and therein shall not in any way be affected or impaired thereby.

SECTION 3.7. Article headings in this Agreement are included herein for convenience of reference only, and shall not constitute a part of this Agreement

for any other purpose.

SECTION 3.8. This is not a third-party beneficiary contract and nothing herein, express or implied, is intended or shall be construed to confer upon or to give to any person or corporation, other than the parties hereto, any right, remedy or claim under or by reason of this Agreement, and the covenants, stipulations and agreement contained herein are and shall be for the sole and exclusive benefit of the parties hereto, their successors and assigns.

SECTION 3.9. NATUS HEREBY REPRESENTS AND WARRANTS TO SHAREHOLDER THAT THE OBLIGATIONS EVIDENCED BY THIS AGREEMENT ARE STRICTLY AND EXCLUSIVELY FOR WORKING CAPITAL PURPOSES ONLY.

ARTICLE 4

SECTION 4.1. Subject to the terms of a Stock Warrant Agreement ("Warrant") in a form substantially similar to the form attached hereto and labeled as Exhibit B, Natus agrees to issue, for each full dollar of the Loan, a warrant to purchase one share of Natus Corporation common stock at the purchase price of one dollar ($1.00) per share of common stock.

SECTION 4.2. Unless otherwise sooner terminated, the term of the Warrant shall automatically expire on the Maturity Date of the Loan (defined as "Warrant Term").

SECTION 4.3. The Warrant may be exercised in full or in part at any time during the Warrant Term; provided, however, it is acknowledged and understood by the parties hereto that no fractional shares will be issued under the Warrant.

ACCORDINGLY, the parties hereto have caused this Agreement to be executed as of the date first written above.

NATUS CORPORATION		*SHAREHOLDER*
BY:	*/s/Kathleen A. Billings*	*/s/Thomas E. Brunelle*
		(Signature)
ITS:	*President*	*Thomas E. Brunelle*
		(Print Name)
DATE:	*September 5, 1995*	*10701 Red Circle Drive*
		Address
		Minnetonka MN 55343
		City State Zip

Exhibit A

*$ 227,959.00***

Minneapolis, Minnesota
September 5, 1995

NON-NEGOTIABLE PROMISSORY NOTE

*FOR VALUE RECEIVED, the undersigned, Natus Corporation (hereinafter "Payor") , promises to pay to the order of Lectec Corporation (hereinafter the "Holder") , in lawful money of the United States of America, the principal sum of $227,959** Dollars ($ 227,959.00**) , together with interest on the unpaid balance of such amount at the rate of seven percent (7%) per annum.*

This Note is referred to in that certain Working Capital Loan Agreement (the "Agreement") dated September 5, 1995 between the Payor and Holder. This Note is issued, is to be repaid, and may be accelerated under the terms and provisions of the Agreement. The Holder is entitled to all the benefits provided for in the Agreement, or referred to therein. The provisions of the Agreement are incorporated by reference herein with the same force and effect as if fully set forth herein.

On September 5 1996, all principal and interest hereunder shall be immediately due and payable in full. All or any part of the balance due hereunder may be prepaid at any time without penalty. All payments on this Note shall be applied first to the payment of accrued interest, and the balance shall be applied to principal.

The Holder may, at its option, record on this Note by appropriate notation the date and amount of each payment of principal made by the Payor. Each such entry shall be prima facie evidence of the amount outstanding hereunder; provided, however, that the failure by the Holder to make any such endorsement shall not affect the obligations of the Payor hereunder. Absent manifest error, this Note shall be conclusive evidence of the principal and interest due hereunder.

The Payor hereby waives presentment and demand for payment, notice of dishonor, protest and notice of protest, and agrees to pay all reasonable costs of collection, including reasonable attorneys, fees.

No failure to accelerate the debt evidenced hereby by reason of a default hereunder shall be construed to be a waiver of the right to insist upon prompt payment thereafter, or shall be deemed to be a novation of this Note, or as a reinstatement of the debt evidenced hereby, or as a waiver of such right of acceleration or any other right, or be construed so as to preclude the exercise of any right which the Holder may have, whether by the laws of the state governing this Note, by agreement, or otherwise.

This Note may not be changed orally, but only by an agreement in writing signed by the party against whom such agreement is sought to be enforced. This Note shall be governed by and construed in accordance with the laws of the State of Minnesota.

NATUS CORPORATION

By: /s/Kathleen A. Billings
Its: President

Exhibit B

WARRANT TO PURCHASE SHARES OF COMMON STOCK OF NATUS CORPORATION

For value received, LecTec Corporation ("Investor"), is entitled to subscribe to and purchase from Natus Corporation, a Minnesota corporation (the "Company") , up to 277,959 (227,959) fully paid and nonassessable shares of the Company's common stock at the price of One Dollar ($1.00) per share (the "warrant exercise price").

This warrant may be exercised by Investor at any time or from time to time after September 5, 1995 and prior to September 5, 1996. This warrant is subject to the following provisions, terms and conditions:

1. The rights represented by this warrant may be exercised by the holder hereof, in whole or in part, by written notice of exercise delivered to the Company at least twenty (20) days prior to the intended date of exercise and by the surrender of this warrant (properly endorsed if required) at the principal office of the Company and upon payment to it by cash, certified check or bank draft of the purchase price for such shares. The shares so purchased shall be deemed to be issued as of the close of business on the date on which this warrant has been so exercised by payment to the Company of the warrant exercise price. Certificates for the shares of stock so purchased shall be delivered to the holder within fifteen (15) days after the rights represented by this warrant shall have been so exercised, and, unless this warrant has expired, a new warrant representing the number of shares, if any, with respect to which this warrant has not been exercised shall also be delivered to the holder hereof within such time. No fractional shares shall be issued upon the exercise of this warrant.

2. The Company covenants and agrees that all shares that may be issued upon the exercise of the rights represented by this warrant shall, upon issuance, be duly authorized and issued, fully paid and nonassessable shares. The Company further covenants and agrees that during the period within which the rights represented by this warrant may be exercised, the Company will at all times have authorized, and reserved for the purpose of issue or transfer upon exercise of the subscription rights evidenced by this warrant, a sufficient number of shares of its common stock to provide for the exercise of the rights represented by this warrant.

3. This warrant shall not entitle the holder hereof to any voting rights or other rights as a shareholder of the Company.

4. This warrant and all rights hereunder are not transferable, in whole or in part, without the express prior written consent of the Company, which consent may be withheld for any reason.

5. Neither this warrant nor any term hereof may be changed, waived, discharged or terminated orally, but only by an instrument in writing signed by the party against which enforcement of the change, waiver, discharge or termination is sought.

IN WITNESS WHEREOF, the Company has caused this warrant to be signed and delivered by a duly authorized officer as of the 5th day of September 5, 1995

Natus Corporation

By: /s/Kathleen A. Billings

Its: President

WARRANT EXERCISE
(To be signed only upon exercise of warrant)

*The undersigned, the holder of the foregoing warrant, hereby irrevocably elects to exercise the purchase right represented by such warrant for, and to purchase thereunder, the shares of common stock of Natus Corporation, to which such warrant relates and herewith makes payment of $277,959.00** therefor in cash or by check and requests that the certificates for such shares be issued in the name of, and be delivered to whose address is set forth below the signature of the undersigned.*

Dated: _____

_____
(Signature)

_____
(Address)

EXHIBIT 23.01

AUDITORS' CONSENT

We have issued our report dated August 26, 1996 accompanying the consolidated financial statements included in the Annual Report of LecTec Corporation on Form 10-K for the year ended June 30, 1996. We hereby consent to the incorporation by reference of said report in the Registration Statements of LecTec Corporation on Forms S-8 (File No. 33-121780, effective April 21, 1987 and No. 33-45931, effective February 21, 1992).

Grant Thornton LLP

Minneapolis, Minnesota
September 23, 1996

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