

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 1995.

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

Commission file number: 0-16159

LECTEC CORPORATION
(Exact name of Registrant as specified in its charter)

Minnesota
(State or other jurisdiction of
incorporation or organization)

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

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

55343
(Zip Code)

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

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

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

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

Yes No

The number of shares outstanding of the registrant's common stock as of February
1, 1996 was 3,799,763 shares.

LECTEC CORPORATION

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LECTEC CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

<TABLE>
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	December 31, 1995	June 30, 1995
	-----	-----
<S>	<C>	<C>
ASSETS		
	(Unaudited)	
CURRENT ASSETS		
Cash and cash equivalents	\$ 491,633	\$ 839,942
Receivables		
Trade, less allowance for doubtful accounts		
of \$20,458 (unaudited) and \$18,000 at		
December 31, 1995 and June 30, 1995,		
respectively	1,801,049	2,027,985
Refundable income taxes	125,357	119,540
Other	291,032	268,247
	-----	-----
	2,217,438	2,415,772
Inventories		
Raw materials	1,184,550	1,162,559
Work-in-process	289,867	218,351
Finished goods	576,633	716,344
	-----	-----
Total inventories	2,051,050	2,097,254
Prepaid expenses and other	127,205	229,796
Deferred tax asset	254,000	254,000
	-----	-----
Total current assets	5,141,326	5,836,764
PROPERTY, PLANT AND EQUIPMENT - AT COST		
Building and improvements	1,611,852	1,673,069
Equipment	6,154,065	5,447,479
Furniture and fixtures	351,579	422,265
	-----	-----
	8,117,496	7,542,813
Less accumulated depreciation	3,122,176	2,813,760
	-----	-----
	4,995,320	4,729,053
Construction in progress	75,053	583,023
Land	247,731	247,731
	-----	-----
	5,318,104	5,559,807
OTHER ASSETS		
Patents and trademarks, less accumulated		
amortization of \$618,625 (unaudited) and \$554,286		
at December 31, 1995 and June 30, 1995, respectively	389,619	386,470
Goodwill, less accumulated amortization of \$344,169		
(unaudited) and \$245,835 at December 31, 1995		
and June 30, 1995, respectively	245,831	344,165
Long-term investments	577,967	568,156
Other	719,856	23,784
	-----	-----
	1,933,273	1,322,575
	-----	-----
	\$12,392,703	\$12,719,146
	=====	=====

</TABLE>

See accompanying notes to the consolidated financial statements

<TABLE>
<CAPTION>

	December 31, 1995	June 30, 1995
	-----	-----
<S>	<C>	<C>
LIABILITIES AND SHAREHOLDERS' EQUITY	(Unaudited)	
CURRENT LIABILITIES		
Notes payable	\$ 83,595	\$ 0
Accounts payable	777,415	771,471
Accrued expenses		
Payroll related	344,076	375,282
Distributor bonuses	67,374	71,384
Product returns	0	77,831
Other	446,201	50,000
	-----	-----
Total current liabilities	1,718,661	1,345,968
DEFERRED INCOME TAXES	167,000	167,000
SHAREHOLDERS' EQUITY		
Common stock, \$.01 par value: 15,000,000 shares authorized; issued and outstanding: 3,797,500 shares (unaudited) at December 31, 1995 and 3,786,500 shares at June 30, 1995	37,975	37,865
Additional paid-in capital	10,064,045	10,013,949
Unrealized losses on securities available-for-sale	(41,004)	(50,816)
Retained earnings	446,026	1,205,180
	-----	-----
	10,507,042	11,206,178
	-----	-----
	\$ 12,392,703	\$ 12,719,146
	=====	=====

</TABLE>

See accompanying notes to the consolidated financial statements

LECTEC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

<TABLE>
<CAPTION>

	Three months ended December 31,		Six months ended December 31,	
	1995	1994	1995	1994
	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>
Revenues	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Product sales	\$ 3,255,110	\$ 3,685,809	\$ 6,717,561	\$ 6,590,332
	-----	-----	-----	-----
Total revenues	3,255,110	3,685,809	6,717,561	6,590,332
Cost of goods sold	1,957,457	2,380,262	4,080,704	3,937,476
	-----	-----	-----	-----
Gross profit	1,297,653	1,305,547	2,636,857	2,652,856
Operating expenses				
Selling, general and administrative	1,468,050	884,880	2,409,540	1,673,975
Research and development	503,518	411,151	1,014,551	888,372
	-----	-----	-----	-----
	1,971,568	1,296,031	3,424,091	2,562,347
	-----	-----	-----	-----
Operating profit (loss)	(673,915)	9,516	(787,234)	90,509
Other income (expense)				
Interest income	5,782	7,875	15,605	27,500
Dividend income	10,937	11,194	20,068	20,425
Interest expense	(6,415)	0	(6,415)	(5,659)
Other	0	7,859	0	7,664

	10,304	26,928	29,258	49,930
Earnings (loss) before income tax expense	(663,611)	36,444	(757,976)	140,439
Income tax expense	176	(2,887)	1,177	22,172
Net earnings (loss)	(\$ 663,787)	\$ 39,331	(\$ 759,153)	\$ 118,267
Net earnings (loss) per common and common equivalent share	(\$ 0.17)	\$ 0.01	(\$ 0.20)	\$ 0.03
Weighted average number of common and common equivalent shares outstanding during the period	3,796,824	3,765,938	3,792,566	3,763,138

</TABLE>

See accompanying notes to the consolidated financial statements

LECTEC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

	Six months Ended December 31, 1995	Six months Ended December 31, 1994
	<C> (Unaudited)	<C> (Unaudited)
Cash flows from operating activities:		
Net earnings (loss)	(\$ 759,153)	\$ 118,267
Adjustments to reconcile net earnings (loss) to net cash used in operating activities:		
Depreciation and amortization	540,304	404,383
Loss on disposal of assets	300,000	0
Changes in operating assets and liabilities:		
Trade and other receivables	189,166	(341,086)
Inventories	(374,784)	(643,967)
Prepaid expenses and other	(76,380)	(188,379)
Accounts payable	5,944	117,425
Accrued expenses	(16,846)	101,506
Net cash used in operating activities	(191,749)	(431,851)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(222,873)	(863,984)
Investment in patents and trademarks	(67,488)	(76,275)
Purchase of marketable securities and other investments	0	(234,100)
Sale of marketable securities and other investments	0	1,613,354
Net cash (used in) provided by investing activities	(290,361)	438,995
Cash flows from financing activities:		
Issuance of common stock	50,206	31,724
Proceeds from notes payable	83,595	0
Net cash provided by financing activities	133,801	31,724
Net (decrease) increase in cash and cash equivalents	(348,309)	38,868
Cash and cash equivalents at beginning of period	839,942	785,770
Cash and cash equivalents at end of period	\$ 491,633	\$ 824,638

</TABLE>

See accompanying notes to the consolidated financial statements

LECTEC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

Disclosures in Financial Statements

	Six months Ended December 31, 1995	Six months Ended December 31, 1994
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(Unaudited) (Unaudited)

Supplemental Disclosures of Cash Flow Information:

Cash paid during the period for:

Interest expense	\$ 0	\$ 0
Income taxes	20,725	44,302

Supplemental Schedule Of Noncash Activities:

During fiscal 1996 the Company recorded the sale of certain assets. The effect of the transaction during the six months ended December 31, 1995 was as follows:

Reduction of accounts receivable	\$ 9,168
Reduction of inventories	420,988
Reduction of prepaid expenses and other	185,765
Reduction of property and equipment	156,160
Reduction of accumulated depreciation	(69,215)

	\$ 702,866
	=====

See accompanying notes to the consolidated financial statements

LECTEC CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 1995

(1) General

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

(2) Sale of the Direct Marketing Related Assets of the Natus Subsidiary

During the quarter ended December 31, 1995 the Company recorded a loss related to the pending sale of the direct marketing related assets of the Natus Corporation subsidiary

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

Results of Operations

Product sales for the second quarter of fiscal 1996 were \$3,255,110 as compared with \$3,685,809 for the second quarter of fiscal 1995. Product sales, for the second quarter, decreased overall by 11.7% from the prior year. The net decrease was the result of decreased medical tape product sales and decreased

therapeutic product sales partially offset by increased conductive product sales. Conductive product sales, the Company's largest product group, increased by 12.9% from the prior year while medical tape product sales decreased by 50.4% and therapeutic product sales decreased by 5.6%. Conductive product sales increased for both diagnostic and hydrogel products as a result of volume increases and increased market share. The medical tape product sales decrease was primarily due to the absence of a major tape converter order in the current year as compared to the prior year. The therapeutic product sales decrease was primarily the result of decreased direct marketing sales of Natus. Product sales for the first six months of fiscal 1996 were \$6,717,561 as compared with \$6,590,332 for the first six months of fiscal 1995. Product sales, for the first six months, increased by 1.9% from the prior year as a result of increased conductive product sales and therapeutic product sales which were partially offset by decreased medical tape product sales. Conductive product sales increased by 5.2% from the prior year primarily as a result of volume increases and increased market share. Medical tape product sales decreased by 10.0% primarily due to the absence of a major tape converter order in the current year as compared to the prior year which more than offset increased sales due to a new product offering and sales to a major new retail customer. Therapeutic product sales increased 10.1% from the prior year primarily due to increased analgesic pain patch sales.

Gross profit for the second quarter of fiscal 1996 was \$1,297,653 as compared with \$1,305,547 compared to the second quarter of fiscal 1995. Gross profit as a percent of total revenues for the second quarter of fiscal 1996 was 39.9% as compared to 35.4% for the second quarter of fiscal 1995. The increase in gross profit percent for the quarter was primarily a reflection of a shift in the sales mix to the higher margin conductive products and an improvement in therapeutic product margins which were partially offset by increased raw material costs for all products. Gross profit for the first six months of fiscal 1996 was \$2,636,857 as compared with \$2,652,856 compared to the first six months of fiscal 1995. Gross profit as a percent of total revenues for the first six months of fiscal 1996 was 39.3% as compared to 40.3% for the first six months of fiscal 1995. The decrease in gross profit percent for the first six months was primarily due to increased raw material costs for all products which were partially offset by a shift in the sales mix to the higher margin conductive and therapeutic products.

Selling, general and administrative expenses were \$1,468,050 and \$884,880 during the second quarters of fiscal 1996 and fiscal 1995, respectively. Selling, general and administrative expenses for the second quarters of fiscal 1996 and 1995, as a percentage of total revenues, were 45.1% and 24.0%, respectively. Selling, general and administrative expenses were \$2,409,540 and \$1,673,975 during the first six months of fiscal 1996 and fiscal 1995, respectively. Selling, general and administrative expenses for the first six months of fiscal 1996 and 1995, as a percentage of total revenues, were 35.9% and 25.4%, respectively. Increased selling, general and administrative expenses associated with the operations of the Natus subsidiary and the sale of the direct marketing related assets of the Natus subsidiary were primarily responsible for the increase in both the second quarter and the first six months.

Research and development expenses for the second quarters of fiscal 1996 and 1995 were \$503,518 and \$411,151, respectively. Research and development expenses for the second quarter, as a percentage of total revenues, were 15.5% and 11.2% for fiscal 1996 and 1995, respectively. Research and development expenses for the first six months of fiscal 1996 increased to \$1,014,551 from \$888,372 in fiscal 1995. Research and development expenses for the first six months, as a percentage of total revenues, were 15.1% and 13.5% for fiscal 1996 and 1995, respectively. The increase in expense for both the quarter and the first six months is primarily attributable to the research and development costs associated with the non-nicotine smoking cessation product and the pain patch program.

Other income (expense) decreased in the second quarter of fiscal 1996 to \$10,304 from \$26,928 in the second quarter of fiscal 1995. Other income (expense) decreased in the first six months of fiscal 1996 to \$29,258 from \$49,930 in the first six months of fiscal 1995. The decline in both the second quarter and the first six months resulted primarily from a reduction of interest and dividend income due to the liquidation of short-term investments to finance the acquisition of a new therapeutic production line as well as to finance the losses associated with the Natus subsidiary.

The Company had a loss before income tax expense of \$663,611 in the second quarter of fiscal 1996 compared to earnings before income tax expense of \$36,444 in the second quarter of fiscal 1995. The Company had a loss before income tax expense of \$757,976 in the first six months of fiscal 1996 compared to earnings before income tax expense of \$140,439 in the first six months of fiscal 1995. The decrease in earnings before income taxes for the second quarter and the first six months was primarily the result of the loss on the sale of the direct marketing related assets of the Natus subsidiary, the operating loss and parent Company expenses associated with the direct marketing activities of the Natus subsidiary, increased raw material costs for products sold and increased research and development expense.

The Company did not record a tax benefit in connection with losses generated during the second quarter and year-to-date as the losses relate primarily to the Natus subsidiary. The Natus losses can not be utilized by Lectec at this time.

Liquidity and Capital Resources

The Company has used internally generated cash to support growth and capital spending. The Company has a \$1,000,000 line of credit available to meet current operating requirements. The Company estimates that capital expenditures will approach \$500,000 for equipment and capital improvements during fiscal 1996 with expenditures anticipated to be financed by operations. The Company continues to have a strong Balance Sheet with no long-term debt and a current ratio at the end of the second quarter of fiscal 1996 of 2.99 as compared to 4.34 at the end of fiscal 1995. Working capital, at the end of the second quarter of fiscal 1996, decreased to \$3,422,665 from \$4,490,796 at the end of fiscal 1995.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities

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

Item 3. Defaults Upon Senior Securities

Not applicable.

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

None

Item 5. Other Information

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

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits - None.

(b) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LECTEC CORPORATION

Date February 14, 1996

/s/ Erwin W. Templin II

Erwin W. Templin II, EVP & CFO

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