

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

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**FORM 10-Q**

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

**For the quarterly period ended November 30, 2012**

**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: 001-11038**

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**NORTHERN TECHNOLOGIES INTERNATIONAL CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**41-0857886**

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

**4201 Woodland Road**

**Circle Pines, Minnesota 55014**

(Address of principal executive offices) (Zip code)

**(763) 225-6600**

(Registrant's telephone number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

As of January 11, 2013, there were 4,418,821 shares of common stock of the registrant outstanding.

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**NORTHERN TECHNOLOGIES INTERNATIONAL CORPORATION**  
**FORM 10-Q**  
**November 30, 2012**

**TABLE OF CONTENTS**

<b><u>Description</u></b>	<b><u>Page</u></b>
<b><u>PART I.</u></b>	
<b><u>FINANCIAL INFORMATION</u></b>	
<b><u>Item 1.</u></b>	
<b><u>Financial Statements</u></b>	
<b><u>Consolidated Balance Sheets as of November 30, 2012 (unaudited) and August 31, 2012</u></b>	<b><u>3</u></b>
<b><u>Consolidated Statements of Operations (unaudited) for the Three Months Ended November 30, 2012 and 2011</u></b>	<b><u>4</u></b>
<b><u>Consolidated Statements of Comprehensive Income (unaudited) for the Three Months Ended November 30, 2012 and 2011</u></b>	<b><u>5</u></b>
<b><u>Consolidated Statements of Cash Flows (unaudited) for the Three Months Ended November 30, 2012 and 2011</u></b>	<b><u>6</u></b>
<b><u>Notes to Consolidated Financial Statements (unaudited)</u></b>	<b><u>7-17</u></b>
<b><u>Item 2.</u></b>	
<b><u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b><u>18-32</u></b>
<b><u>Item 3.</u></b>	
<b><u>Quantitative and Qualitative Disclosures about Market Risk</u></b>	<b><u>32</u></b>
<b><u>Item 4.</u></b>	
<b><u>Controls and Procedures</u></b>	<b><u>32</u></b>
<b><u>PART II.</u></b>	
<b><u>OTHER INFORMATION</u></b>	
<b><u>Item 1.</u></b>	
<b><u>Legal Proceedings</u></b>	<b><u>34</u></b>
<b><u>Item 1A.</u></b>	
<b><u>Risk Factors</u></b>	<b><u>34</u></b>
<b><u>Item 2.</u></b>	
<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	<b><u>34</u></b>
<b><u>Item 3.</u></b>	
<b><u>Defaults Upon Senior Securities</u></b>	<b><u>34</u></b>
<b><u>Item 4.</u></b>	
<b><u>Mine Safety Disclosures</u></b>	<b><u>34</u></b>
<b><u>Item 5.</u></b>	
<b><u>Other Information</u></b>	<b><u>34</u></b>
<b><u>Item 6.</u></b>	
<b><u>Exhibits</u></b>	<b><u>34-35</u></b>
<b><u>SIGNATURE PAGE</u></b>	<b><u>36</u></b>
<b><u>EXHIBIT INDEX</u></b>	<b><u>37</u></b>

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*This quarterly report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by those sections. For more information, see “Part I. Financial Information – Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations– Forward-Looking Statements.”*

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*As used in this report, references to “NTIC,” the “Company,” “we,” “our” or “us,” unless the context otherwise requires, refer to Northern Technologies International Corporation and its wholly owned subsidiaries, NTI Facilities, Inc. and Northern Technologies Holding Company, LLC, and its majority owned subsidiaries, Zerust Prevenção de Corrosão S.A. and NTI Asean LLC, all of which are consolidated on NTIC’s consolidated financial statements.*

*NTIC’s consolidated financial statements do not include the accounts of any of its joint ventures. Except as otherwise indicated, references in this report to NTIC’s joint ventures do not include NTIC’s majority owned Brazilian subsidiary, Zerust Prevenção de Corrosão S.A., or NTIC’s majority owned subsidiary, NTI Asean LLC, which is a holding company that holds investments in eight entities that operate in the Association of Southeast Asian Nations (ASEAN) region, including the following countries: China, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand.*

*As used in this report, references to “Zerust Brazil” refer to NTIC’s majority owned Brazilian subsidiary, Zerust Prevenção de Corrosão S.A.*

*As used in this report, references to “NTI Asean” refer to NTIC’s majority owned holding company subsidiary, NTI Asean LLC.*

*As used in this report, references to “HNTI” refer to NTIC’s joint venture in India, Harita NTI Limited.*

*As used in this report, references to “EXCOR” refer to NTIC’s primary joint venture in Germany, Excor Korrosionsschutz – Technologien und Produkte GmbH.*

*All trademarks, trade names or service marks referred to in this report are the property of their respective owners.*

**PART I - FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**NORTHERN TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS AS OF NOVEMBER 30, 2012 (UNAUDITED)  
AND AUGUST 31, 2012 (AUDITED)**

	<u>November 30, 2012</u>	<u>August 31, 2012</u>
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 6,819,036	\$ 4,137,547
Receivables:		
Trade excluding joint ventures, less allowance for doubtful accounts of \$20,000 at November 30, 2012 and August 31, 2012	2,684,239	2,516,961
Trade joint ventures	942,500	734,543
Fees for services provided to joint ventures	2,328,455	1,316,933
Income taxes	253,759	58,129
Inventories	4,989,833	4,151,197
Prepaid expenses	698,808	548,331
Deferred income taxes	596,085	596,085
Total current assets	<u>19,312,715</u>	<u>14,059,726</u>
PROPERTY AND EQUIPMENT, NET	<u>4,238,359</u>	<u>4,288,618</u>
OTHER ASSETS:		
Investments in joint ventures	21,435,223	21,461,492
Deferred income taxes	1,030,610	1,030,610
Patents and trademarks, net	1,012,401	961,181
Other	76,000	76,000
Total other assets	<u>23,554,234</u>	<u>23,529,283</u>
Total assets	<u>\$ 47,105,308</u>	<u>\$ 41,877,627</u>
<b>LIABILITIES AND EQUITY</b>		
CURRENT LIABILITIES:		
Current portion of note payable	76,119	76,120
Accounts payable	1,810,330	1,818,309
Accrued liabilities:		
Payroll and related benefits	1,699,938	1,565,866
Deferred joint venture royalties	288,000	288,000
Other	131,457	251,350
Total current liabilities	<u>4,005,844</u>	<u>3,999,645</u>
NOTE PAYABLE, NET OF CURRENT PORTION (Note 7)	914,384	933,413
COMMITMENTS AND CONTINGENCIES (Note 13)		
EQUITY:		
Preferred stock, no par value; authorized 10,000 shares; none issued and outstanding	—	—
Common stock, \$0.02 par value per share; authorized 10,000,000 shares; issued and outstanding 4,418,821 and 4,403,656, respectively	88,351	88,073
Additional paid-in capital	11,305,834	11,130,966
Retained earnings	25,649,655	25,260,034
Accumulated other comprehensive income	664,247	277,583
Stockholders' equity	<u>37,708,087</u>	<u>36,756,656</u>
Non-controlling interest	4,476,993	187,913
Total equity	<u>42,185,080</u>	<u>36,944,569</u>
Total liabilities and equity	<u>\$ 47,105,308</u>	<u>\$ 41,877,627</u>

See notes to consolidated financial statements.

**NORTHERN TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**  
**FOR THE THREE MONTHS ENDED NOVEMBER 30, 2012 AND 2011**

	<b>Three Months Ended</b>	
	<b>November 30, 2012</b>	<b>November 30, 2011</b>
<b>NET SALES:</b>		
Net sales, excluding joint ventures	\$ 4,770,387	\$ 4,277,643
Net sales, to joint ventures	521,360	554,471
Total net sales	<u>5,291,747</u>	<u>4,832,114</u>
Cost of goods sold	3,690,972	3,209,476
Gross profit	<u>1,600,775</u>	<u>1,622,638</u>
<b>JOINT VENTURE OPERATIONS:</b>		
Equity in income of joint ventures	1,154,296	1,357,680
Fees for services provided to joint ventures	1,846,277	1,445,252
Total joint venture operations	<u>3,000,573</u>	<u>2,802,932</u>
<b>OPERATING EXPENSES:</b>		
Selling expenses	1,171,095	1,108,486
General and administrative expenses	1,248,696	1,270,013
Expenses incurred in support of joint ventures	369,687	200,264
Research and development expenses	938,206	814,305
Total operating expenses	<u>3,727,684</u>	<u>3,393,068</u>
OPERATING INCOME	873,664	1,032,502
INTEREST INCOME	25,346	8,060
INTEREST EXPENSE	(6,474)	(5,966)
OTHER INCOME	—	6,825
INCOME BEFORE INCOME TAX EXPENSE	892,536	1,041,421
INCOME TAX EXPENSE	<u>134,000</u>	<u>106,000</u>
NET INCOME	758,536	935,421
NET INCOME (LOSS) ATTRIBUTABLE TO NON CONTROLLING INTEREST	<u>368,914</u>	<u>(23,336)</u>
NET INCOME ATTRIBUTABLE TO NTIC	<u>\$ 389,622</u>	<u>\$ 958,757</u>
<b>NET INCOME ATTRIBUTABLE TO NTIC PER COMMON SHARE:</b>		
Basic	<u>\$ 0.09</u>	<u>\$ 0.22</u>
Diluted	<u>\$ 0.09</u>	<u>\$ 0.22</u>
<b>WEIGHTED AVERAGE COMMON SHARES ASSUMED OUTSTANDING:</b>		
Basic	<u>4,406,205</u>	<u>4,355,666</u>
Diluted	<u>4,440,436</u>	<u>4,433,724</u>

See notes to consolidated financial statements.

**NORTHERN TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**  
**FOR THE THREE MONTHS ENDED NOVEMBER 30, 2012 AND 2011**

	<b>Three Months Ended</b>	
	<b>November 30, 2012</b>	<b>November 30, 2011</b>
NET INCOME	\$ 758,536	\$ 935,421
OTHER COMPREHENSIVE INCOME (LOSS) – FOREIGN CURRENCY TRANSLATION ADJUSTMENT	421,185	(1,188,071)
COMPREHENSIVE INCOME (LOSS)	1,179,721	(252,650)
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO NONCONTROLLING INTERESTS	403,435	(33,142)
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO STOCKHOLDERS	<u>\$ 776,286</u>	<u>\$ (219,508)</u>

See notes to consolidated financial statements.

**NORTHERN TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**THREE MONTHS ENDED NOVEMBER 30, 2012 AND 2011**

	<b>Three Months Ended</b>	
	<b>November 30, 2012</b>	<b>November 30, 2011</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 758,536	\$ 935,421
Adjustments to reconcile net income to net cash used in operating activities:		
Expensing of fair value of stock options vested	43,393	72,523
Depreciation expense	105,688	80,887
Amortization expense	17,445	38,713
Equity in income from joint ventures	(1,154,297)	(1,357,680)
Changes in current assets and liabilities:		
Receivables:		
Trade, excluding joint ventures	(205,361)	(410,029)
Trade, joint ventures	(207,957)	144,157
Fees for services receivables, joint ventures	330,564	(38,883)
Income taxes	(196,635)	(1,396)
Inventories	(865,175)	(158,234)
Prepaid expenses and other	(151,029)	(349,112)
Accounts payable	24,296	(489,032)
Income tax payable	4,191	(17,512)
Accrued liabilities	22,201	(235,365)
Net cash used in operating activities	<u>(1,474,140)</u>	<u>(1,785,543)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Dividends received from joint ventures	2,676,337	2,031,450
Additions to property and equipment	(67,165)	(51,031)
Effect of Asean consolidation on cash (Note 2)	1,612,768	—
Additions to patents	(68,665)	(44,702)
Net cash provided by investing activities	<u>4,153,275</u>	<u>1,935,717</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of note payable	(19,030)	(19,029)
Dividend received by non controlling interest	(72,842)	—
Proceeds from employee stock purchase plan	28,938	22,414
Proceeds from exercise of stock options	102,815	—
Net cash provided by financing activities	<u>39,881</u>	<u>3,385</u>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH:</b>	<u>(37,527)</u>	<u>(12,550)</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>2,681,489</b>	<b>141,009</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>4,137,547</b>	<b>3,266,362</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b><u>\$ 6,819,036</u></b>	<b><u>\$ 3,407,371</u></b>

See notes to consolidated financial statements.

**1. INTERIM FINANCIAL INFORMATION**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all necessary adjustments, which are of a normal recurring nature, and present fairly the consolidated financial position of Northern Technologies International Corporation and its subsidiaries (the Company) as of November 30, 2012 and August 31, 2012 and the results of their operations for the three months ended November 30, 2012 and 2011 and their cash flows for the three months ended November 30, 2012 and 2011, in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP).

Certain amounts reported in the consolidated financial statements for the previous reporting periods have been reclassified to conform to the current period presentation. These reclassifications did not have a material impact on the Company's previously reported consolidated balance sheets or statements of cash flows.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the Company's annual report on Form 10-K for the fiscal year ended August 31, 2012. These consolidated financial statements also should be read in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section appearing in this report.

Operating results for the three months ended November 30, 2012 are not necessarily indicative of the results that may be expected for the full fiscal year ending August 31, 2013.

The Company evaluates events occurring after the date of the consolidated financial statements requiring recording or disclosure in the consolidated financial statements.

**2. NTI ASEAN**

NTI Asean LLC (NTI Asean) is an entity that holds investments in eight entities operating in the Association of Southeast Asian Nations (ASEAN) region, including the following countries: China, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand.

Prior to September 1, 2012, the Company owned 50% of NTI Asean, which it considered to be less than a majority, of the equity and voting rights and accounted for its investment using the equity method. On September 1, 2012, the Company obtained an additional 10% ownership interest in NTI Asean in exchange for a license agreement, and thereafter holds 60% of the equity and voting rights of NTI Asean.

The Company accounted for the transaction resulting in the additional ownership as a business combination. Beginning in the first quarter of fiscal 2013, the Company consolidated the results of NTI Asean. Immediately prior to the transaction, the Company re-measured the fair value of NTI Asean and determined that there was no difference between the fair value and the book value of the entity. As a result, there was no accounting impact related to the business combination in the statement of operations.

The Company determined the fair value of NTI Asean using the capitalized income method, including a capitalization rate of 25%. The allocation of the total transaction amount was as follow:

The allocation of the total transaction amount was as follow:

**Net assets acquired (liabilities assumed):**

Cash and cash equivalents	\$ 1,613,000
Accounts receivables	1,342,000
Investments in JV	4,967,000
Value of assets	<u>\$ 7,922,000</u>

**Purchase price:**

Fair value of non-controlling interest	\$ 3,961,000
Value of previously held interest	3,961,000
Told consideration	<u>\$ 7,922,000</u>

The following is a summary of certain line items of the Company's consolidated statement of operations for the three months ended November 30, 2011 as reported and on a pro forma basis, assuming the consolidation of NTI Asean on the Company's consolidated financial statements as of the beginning of such period:

	<u>As Reported</u>	<u>NTI Asean</u>	<u>Eliminated in Consolidation</u>	<u>Pro Forma</u>
Net sales	\$ 4,832,114	\$ —	\$ —	\$ 4,832,114
Cost of goods sold	3,209,476	—	—	3,209,476
Gross profit	1,622,638	—	—	1,622,638
Joint venture operations	2,802,932	830,898	(369,461)	3,264,369
Operating expenses	3,393,068	2,665	—	3,395,733
Operating income	1,032,502	828,233	(369,461)	1,491,274
Income before income tax expense	1,041,421	828,233	(369,461)	1,500,193
Income tax expense	106,000	89,311	—	195,311
Net income	935,421	738,922	(369,461)	1,304,882
Net income attributable to non-controlling interest	(23,336)	(295,569)	—	(318,905)
Net income attributable to NTIC	958,757	443,535	(369,461)	1,032,831
Net income per common diluted share	\$ 0.22	\$ 0.10	\$ (0.08)	\$ 0.24

**3. INVENTORIES**

Inventories consisted of the following:

	<u>November 30, 2012</u>	<u>August 31, 2012</u>
Production materials	\$ 1,141,205	\$ 1,462,615
Finished goods	3,848,628	2,688,582
	<u>\$ 4,989,833</u>	<u>\$ 4,151,197</u>

**4. PROPERTY AND EQUIPMENT, NET**

Property and equipment, net consisted of the following:

	<b>November 30, 2012</b>	<b>August 31, 2012</b>
Land	\$ 310,365	\$ 310,365
Buildings and improvements	3,540,275	3,406,674
Machinery and equipment	2,826,615	2,908,021
	<u>6,677,255</u>	<u>6,625,060</u>
Less accumulated depreciation	(2,438,896)	(2,336,442)
	<u>\$ 4,238,359</u>	<u>\$ 4,288,618</u>

## 5. PATENTS AND TRADEMARKS, NET

Patents and trademarks, net consisted of the following:

	<b>November 30, 2012</b>	<b>August 31, 2012</b>
Patents and trademarks	\$ 2,012,729	\$ 1,945,785
Less accumulated amortization	(1,000,328)	(984,604)
	<u>\$ 1,012,401</u>	<u>\$ 961,181</u>

Patent and trademark costs are amortized over seven years. Costs incurred related to patents and trademarks are capitalized until filed and approved, at which time the amounts capitalized to date are amortized and any further costs, including maintenance costs, are expensed as incurred. Amortization expense is estimated to approximate \$80,000 in each of the next five fiscal years.

## 6. INVESTMENTS IN JOINT VENTURES

The financial statements of the Company's foreign joint ventures are initially prepared using the accounting principles accepted in the respective joint ventures' countries of domicile. Amounts related to foreign joint ventures reported in the below tables and the accompanying consolidated financial statements have subsequently been adjusted to approximate U.S. GAAP in all material respects. All material profits recorded on sales from the Company to its joint ventures of goods that remain in inventory, have been eliminated for financial reporting purposes.

Financial information from the audited and unaudited financial statements of the Company's joint venture in Germany, Excor Korrosionsschutz – Technologien und Produkte GmbH (EXCOR), joint venture in China and all of the Company's other joint ventures, are summarized as follows:

	<b>At November 30, 2012</b>			
	<b>Total</b>	<b>EXCOR</b>	<b>China</b>	<b>All Other</b>
Current assets	\$ 61,936,535	\$ 21,440,244	\$ 11,933,790	\$ 28,562,501
Total assets	68,157,107	23,756,509	11,968,500	32,432,098
Current liabilities	20,079,934	4,737,085	4,822,792	10,520,057
Noncurrent liabilities	4,815,797	—	856,547	3,959,250
Joint ventures' equity	43,261,376	19,019,424	6,289,161	17,952,791
Northern Technologies International Corporation's share of joint ventures' equity	21,435,223	9,509,714	3,148,679	8,776,830
Northern Technologies International Corporation's share of joint ventures' undistributed earnings	\$ 19,341,157	\$ 9,478,809	\$ 3,095,230	\$ 6,767,118

**At August 31, 2012**

	<b>NTI</b>			
	<b>Total</b>	<b>EXCOR</b>	<b>ASEAN</b>	<b>All Other</b>
Current assets	\$ 61,973,725	\$ 24,357,139	\$ 15,358,967	\$ 22,257,619
Total assets	68,585,974	26,620,589	15,522,456	26,442,929
Current liabilities	18,686,181	4,749,574	5,763,857	8,172,750
Noncurrent liabilities	4,700,458	—	1,055,965	3,644,493
Joint ventures' equity	45,199,335	21,871,015	8,702,634	14,625,686
Northern Technologies International Corporation's share of joint ventures' equity	21,461,492	10,935,509	\$ 3,685,404	6,840,579
Northern Technologies International Corporation's share of joint ventures' undistributed earnings	\$ 19,403,150	\$ 10,904,604	\$ 3,314,445	\$ 5,184,101

**Three Months Ended November 30, 2012**

	<b>NTI</b>			
	<b>Total</b>	<b>EXCOR</b>	<b>China</b>	<b>All Other</b>
Net sales	\$ 27,524,934	\$ 8,609,463	\$ 3,568,798	\$ 15,346,673
Gross profit	13,127,067	4,434,290	1,730,402	6,962,375
Net income	2,440,560	1,570,374	294,003	576,183
Northern Technologies International Corporation's share of equity in income of joint ventures	\$ 1,154,296	\$ 785,187	\$ 147,001	\$ 222,108

**Three Months Ended November 30, 2011**

	<b>NTI</b>			
	<b>Total</b>	<b>EXCOR</b>	<b>ASEAN</b>	<b>All Other</b>
Net sales	\$ 28,795,232	\$ 8,542,250	\$ 5,022,328	\$ 15,230,654
Gross profit	13,339,072	4,325,802	2,286,705	6,726,565
Net income	2,538,769	1,457,055	738,922	689,348
Northern Technologies International Corporation's share of equity in income of joint ventures	\$ 1,357,680	\$ 728,528	\$ 369,461	\$ 259,691

The Company records expenses that are directly attributable to the joint ventures on the consolidated statements of operations on the line "Expenses incurred in support of joint ventures". The expenses include items such as employee compensation and benefit expenses, travel expense and consulting expense.

The Company did not make any other joint venture investments during the three months ended November 30, 2012 and 2011.

**7. CORPORATE DEBT**

As of November 30, 2012, Northern Technologies Holding Company, LLC (NTI LLC) had a term loan with a principal amount of \$990,503 outstanding that NTI LLC obtained from PNC Bank, National Association (PNC Bank) in connection with the purchase of NTIC's corporate headquarters in September 2006. The term loan matures on January 10, 2016, bears interest at an annual rate based on the daily LIBOR rate plus 2.15% and is payable in consecutive monthly installments equal to approximately \$6,343 (inclusive of principal but exclusive of interest). The term loan is secured by a first lien on the real estate and building owned by NTI LLC and all of the assets of the Company and is guaranteed by the Company.

The Company has a revolving line of credit with PNC Bank of \$3,000,000. No amounts were outstanding under the line of credit as of November 30, 2012 and August 31, 2012. At the option of the Company, outstanding advances under the line of credit bear interest at either (a) an annual rate based on LIBOR plus 2.15% for the applicable LIBOR interest period selected by the Company or (b) at the rate publicly announced by PNC Bank from time to time as its prime rate. Interest is payable in arrears (a) for the portion of advances bearing interest under the prime rate on the last day of each month during the term thereof and (b) for the portion of advances bearing interest under the LIBOR option on the last day of the respective LIBOR interest period selected for such advance. Any unpaid interest is payable on the maturity date. As of November 30, 2012, the interest rate was 3.03% and the weighted average rate was 3.11% for the three months ended November 30, 2012. As of November 30, 2011, the interest rate was 3.09% and the weighted average rate was 3.02% for the three months ended November 30, 2011. The revolving line of credit is secured by cash, receivables and inventory.

The term loan and the line of credit are governed under separate loan agreements (collectively, the Loan Agreements). The Loan Agreements contain standard covenants, including affirmative financial covenants, such as the maintenance of a minimum fixed charge coverage ratio, and negative covenants, which, among other things, limit the incurrence of additional indebtedness, loans and equity investments, disposition of assets, mergers and consolidations and other matters customarily restricted in such agreements. Under the Loan Agreements, the Company is subject to a minimum fixed charge coverage ratio of 1.10:1.00. As of November 30, 2012 the Company was in compliance with all debt covenants.

On December 11, 2012, PNC Bank extended the maturity date of the line of credit from January 9, 2013 to January 8, 2014, and waived a technical covenant default by the Company to deliver quarterly compliance certificates. All other terms of the line of credit and the loan agreement and other documents evidencing the line of credit remain the same.

## 8. STOCKHOLDERS' EQUITY

During the three months ended November 30, 2012, the Company did not purchase or retire any shares of its common stock. The following stock options to purchase shares of common stock were exercised during the three months ended November 30, 2012:

<u>Options Exercised</u>	<u>Exercise Price</u>
25,140	\$ 9.95
1,734	7.65

The Company granted stock options under the Northern Technologies International Corporation Amended and Restated 2007 Stock Incentive Plan (the 2007 Plan) to purchase an aggregate of 118,294 shares of its common stock to various employees and directors during the three months ended November 30, 2012. The weighted average per share exercise price of the stock options is \$10.25, which is equal to the fair market value of the Company's common stock on the date of grant.

During the three months ended November 30, 2011, the Company did not purchase or retire any shares of its common stock, and no stock options to purchase shares of common stock were exercised.

The Company granted stock options under the Northern Technologies International Corporation Amended and Restated 2007 Stock Incentive Plan (the 2007 Plan) to purchase an aggregate of 26,000 shares of its common stock to various employees and directors during the three months ended November 30, 2011. The weighted average per share exercise price of the stock options is \$16.45, which is equal to the fair market value of the Company's common stock on the date of grant.

During the three months ended November 30, 2011, the Company granted stock bonuses under the 2007 Plan for an aggregate of 42,707 shares of its common stock to various employees at a grant price of \$14.42 per share. The aggregate fair value of the shares of the Company's common stock as of the date of grant of the stock bonuses was \$615,830, based on the closing sale price of a share of the Company's common stock on the date of grant. The fair value of common stock granted during the three months ended November 30, 2011 was based on fiscal 2011 performance and was included in accrued liabilities at August 31, 2011.

## 9. NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding. Diluted net income per share assumes the exercise of stock options using the treasury stock method, if dilutive.

Options to purchase shares of common stock of 48,000 were excluded from the computation of common share equivalents for the three months ended November 30, 2012, as the exercise prices of such options were greater than market price of a share of common stock. Options to purchase shares of common stock of 26,000 were excluded from the computation of common share equivalents for the three months ended November 30, 2011, as the exercise prices of such options were greater than market price of a share of common stock.

The following is a reconciliation of the earnings per share computation for the three months ended November 30, 2012 and 2011:

	<b>Three Months Ended</b>	
	<b>November 30, 2012</b>	<b>November 30, 2011</b>
Numerator:		
Net income attributable to NTIC	\$ 389,622	\$ 958,757
Denominator:		
Basic – weighted shares outstanding	4,406,205	4,355,666
Weighted shares assumed upon exercise of stock options	34,231	78,058
Diluted – weighted shares outstanding	4,440,436	4,433,724
Basic earnings per share:	\$ 0.09	\$ 0.22
Diluted earnings per share:	\$ 0.09	\$ 0.22

The dilutive impact summarized above relates to the periods when the average market price of the Company's common stock exceeded the exercise price of the potentially dilutive option securities granted. Earnings per common share were based on the weighted average number of common shares outstanding during the periods when computing the basic earnings per share. When dilutive, stock options are included as equivalents using the treasury stock market method when computing the diluted earnings per share.

## 10. STOCK-BASED COMPENSATION

The Company has two stock-based compensation plans under which stock options and other stock-based awards have been granted, including the Northern Technologies International Corporation Amended and Restated 2007 Stock Incentive Plan and the Northern Technologies International Corporation Employee Stock Purchase Plan (the ESPP). The Compensation Committee of the Board of Directors and the Board of Directors administers these plans.

The 2007 Plan provides for the grant of incentive stock options, non-statutory stock options, stock appreciation rights, restricted stock, stock unit awards, performance awards and stock bonuses to eligible recipients to enable the Company and its subsidiaries to attract and retain qualified individuals through opportunities for equity participation in the Company, and to reward those individuals who contribute to the achievement of the Company's economic objectives. Subject to adjustment as provided in the 2007 Plan, up to a maximum of 800,000 shares of the Company's common stock are issuable under the 2007 Plan. Options granted under the 2007 Plan generally have a term of five years and become exercisable over a three- or four-year period beginning on the one-year anniversary of the date of grant. Options are granted at per share exercise prices equal to the market value of the Company's common stock on the date of grant. To date, only stock options and stock bonuses have been granted under the 2007 Plan.

The maximum number of shares of common stock of the Company available for issuance under the ESPP is 100,000 shares, subject to adjustment as provided in the ESPP. The ESPP provides for six-month offering periods beginning on September 1 and March 1 of each year. The purchase price of the shares is 90% of the lower of the fair market value of common stock at the beginning or end of the offering period. This discount may not exceed the maximum discount rate permitted for plans of this type under Section 423 of the Internal Revenue Code of 1986, as amended. The ESPP is compensatory for financial reporting purposes.

The Company granted options to purchase an aggregate of 96,294 and 26,000 shares of its common stock during the three months ended November 30, 2012 and 2011, respectively. The fair value of option grants is determined at date of grant, using the Black-Scholes option pricing model with the assumptions listed below. Based on these valuations, the Company recognized compensation expense of \$43,393 and \$72,523 during the three months ended November 30, 2012 and 2011, respectively, related to the options that vested during such time period. The stock-based expense recorded reduced after-tax net income per share by \$0.01 for each of the three months ended November 30, 2012 and 2011, respectively. As of November 30, 2012, the total compensation cost for non-vested options not yet recognized in the Company's consolidated statements of operations was \$578,138 net of estimated forfeitures. Additional stock-based compensation expense of \$282,652 is expected through the remainder of fiscal year 2013, and expense of \$181,774 and \$96,841 is expected to be recognized during fiscal 2014 and fiscal 2015, respectively. Future option grants will impact the compensation expense recognized.

The Company currently estimates a ten percent forfeiture rate for stock options and continually reviews this estimate for future periods.

The fair value of each option grant is estimated on the grant date using the Black-Scholes option-pricing model with the following assumptions and results for the grants:

	November 30,	
	2012	2011
Dividend yield	0.00%	0.00%
Expected volatility	48.0%	48.8%
Expected life of option	5-10 years	5 years
Average risk-free interest rate	0.71%	1.31%

The weighted average per share fair value of options granted during the three months ended November 30, 2012 and 2011 was \$5.53 and \$7.14, respectively. The weighted average remaining contractual life of the options outstanding as of November 30, 2012 and 2011 was 4.82 years and 2.81 years, respectively.

## 11. GEOGRAPHIC AND SEGMENT INFORMATION

Net sales by geographic location as a percentage of total consolidated net sales for the three months ended November 30, 2012 and 2011 were as follows:

	Three Months Ended	
	November 30, 2012	November 30, 2011
Inside the U.S.A. to unaffiliated customers	71.2%	68.1%
Outside the U.S.A. to:		
Joint ventures in which the Company is a shareholder directly and indirectly	15.3	15.7
Unaffiliated customers	13.5	16.2
	100.0%	100.0%

Net sales by geographic location are based on the location of the customer.

Fees for services provided to joint ventures by geographic location as a percentage of total fees for services provided to joint ventures during the three months ended November 30, 2012 and 2011 were as follows:

	Three Months Ended November 30,				
	2012	% of Total Fees for Services Provided to Joint Ventures		2011	% of Total Fees for Services Provided to Joint Ventures
		\$	2012		
China*	\$ 493,312	26.7%	\$ —	0.0%	
Germany	242,700	13.1%	249,447	17.3%	
Japan	201,981	10.9%	288,539	20.0%	
Thailand*	153,687	8.3%	—	0.0%	
Korea**	138,742	7.5%	76,465	5.3%	
France	128,502	7.0%	141,639	9.8%	
Poland	111,472	6.0%	97,828	6.8%	
Finland	87,851	4.8%	132,496	9.2%	
Sweden	86,992	4.7%	156,657	10.8%	
United Kingdom	67,058	3.6%	79,499	5.5%	
India	—	0.0%	136,155	9.4%	
Other	133,980	7.4%	86,527	6.0%	
	\$ 1,846,277	100.0%	\$ 1,445,252	100.0%	

\*Joint Ventures owned by NTI Asean.

\*\*Joint Venture owned by NTI Asean as of November 30, 2012, but not as of November 30, 2011. NTI Asean results are not included on the consolidated financial statements for the three months ended November 30, 2011. (See Note 2)

The following table sets forth the Company's net sales for the three months ended November 30, 2012 and 2011 by segment:

	Three Months Ended	
	November 30, 2012	November 30, 2011
ZERUST® sales	\$ 4,795,283	\$ 4,452,646
Natur-Tec® sales	496,464	379,468
<b>Total net sales</b>	<b>\$ 5,291,747</b>	<b>\$ 4,832,114</b>

The following table sets forth the Company's cost of goods sold for the three months ended November 30, 2012 and 2011 by segment:

	November 30, 2012	% of Product Sales*	November 30, 2011	% of Product Sales*
Direct cost of goods sold				
ZERUST®	\$ 2,644,295	55.1%	\$ 2,457,799	55.2%
Natur-Tec®	439,673	88.6%	296,561	78.2%
Indirect cost of goods sold	607,004	NA	455,116	NA
<b>Total net cost of goods sold</b>	<b>\$ 3,690,972</b>		<b>\$ 3,209,476</b>	

\* The percent of segment sales is calculated by dividing the direct cost of goods sold for each individual segment category by the net sales for each segment category.

The Company's management utilizes product net sales and direct and indirect cost of goods sold for each product in reviewing the financial performance of a product type. Further allocation of Company expenses or assets, aside from amounts presented in the tables above, is not utilized in evaluating product performance, nor does such allocation occur for internal financial reporting.

Sales to the Company's joint ventures are included in the foregoing geographic and segment information, however, sales by the Company's joint ventures to other parties are not included. The foregoing geographic and segment information represents only sales and cost of goods sold recognized directly by the Company.

The geographical distribution of key financial statement data is as follows:

	At November 30, 2012		
	Brazil	North America	Total
Total assets	\$ 1,525,725	\$ 45,619,817	\$ 47,105,308

	At August 31, 2012		
	Brazil	North America	Total
Total assets	\$ 1,744,693	\$ 40,132,934	\$ 41,877,627

	Three Months Ended November 30, 2012		
	Brazil	North America	Total
Net sales	\$ 551,814	\$ 4,739,933	\$ 5,291,747
Operating income	\$ (23,148)	\$ 896,812	\$ 873,664

	<b>Three Months Ended November 30, 2011</b>		
	<b>Brazil</b>	<b>North America</b>	<b>Total</b>
Net sales	\$ 604,920	\$ 4,227,194	\$ 4,832,114
Operating income	\$ (155,174)	\$ 1,187,676	\$ 1,032,502

Total assets located in Brazil primarily consist of cash and cash equivalents, customer receivables and inventory. These assets are periodically reviewed to assure the net realizable value from the estimated future production based on forecasted sales exceeds the carrying value of the assets.

## **12. RESEARCH AND DEVELOPMENT**

The Company expenses all costs related to product research and development as incurred. The Company incurred \$938,206 and \$814,305 of expense during the three months ended November 30, 2012 and 2011, respectively, in connection with its research and development activities. The costs related to product research and development contracts of \$68,682 and \$197,000 for the three months ended November 30, 2012 and 2011, respectively. The net fees are accounted for in the "Research and Development Expenses" section of the consolidated statements of operations.

The Company has certain research and development contracts. The Company accrues proceeds received under such contracts and offsets research and development expenses incurred in equal installments over the timelines associated with completion of the contracts' specific objectives and milestones. At November 30, 2012 and August 31, 2012, the Company had \$4,210 and \$96,861, respectively, of deferred amounts in other accrued liabilities as the Company had not yet performed under the obligations of the contract at that time.

## **13. COMMITMENTS AND CONTINGENCIES**

On August 31, 2012, the Board of Directors of the Company, upon recommendation of the Compensation Committee of the Board of Directors, approved the material terms of an annual bonus plan for the Company's executive officers and certain officers and employees for the fiscal year ending August 31, 2013. For fiscal 2013 as in past years, the total amount available under the bonus plan will be up to 25% of the Company's earnings before interest, taxes and other income, as adjusted to take into account amounts to be paid under the bonus plan and certain other adjustments (Adjusted EBITOI), assuming the achievement of at least a minimum Adjusted EBITOI, which is generally 70% of a budgeted target Adjusted EBITOI for fiscal 2013. For each plan participant, 50% of the amount of the participant's individual bonus payout will be determined based upon the participant's individual allocation percentage of the total amount available under the bonus plan and 50% of the participant's payout will be determined based upon the participant's achievement of certain pre-established but more qualitative individual performance objectives. The payment of bonuses under the plan are discretionary and may be paid to executive officer participants in both cash and shares of NTIC common stock, the exact amount and percentages of which will be determined by the Company's Board of Directors, upon recommendation of the Compensation Committee, after the completion of the Company's consolidated financial statements for fiscal 2013. There was \$116,909 for management bonuses accrued for three months ended November 30, 2012 compared to a management bonus accrual of \$320,814 for the three months ended November 30, 2011.

A subsidiary of the Company, NTI Facilities, Inc., leases property located at 23205 Mercantile Road, Beachwood, Ohio. Remaining rentals payable under such leases are as follows: fiscal 2013 - \$187,500; fiscal 2014 - \$59,500 and thereafter - \$0.

Three joint ventures accounted for 65.0% and 55.3% of the Company's trade joint venture receivables at November 30, 2012 and August 31, 2012, respectively.

From time to time, the Company is subject to various claims and legal actions in the ordinary course of its business. The Company is not currently involved in any legal proceeding in which the Company believes, based on information currently available, that there is a reasonable possibility of a material loss.

## ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management’s Discussion and Analysis provides material historical and prospective disclosures intended to enable investors and other users to assess NTIC’s financial condition and results of operations. Statements that are not historical are forward-looking and involve risks and uncertainties discussed under the heading “Part I. Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Forward-Looking Statements.” The following discussion of the results of the operations and financial condition of NTIC should be read in conjunction with NTIC’s consolidated financial statements and the related notes thereto included under the heading “Part I. Item 1. Financial Statements.”

### Business Overview

NTIC develops and markets proprietary environmentally beneficial products and services in over 55 countries either directly or via a network of joint ventures, independent distributors and agents. NTIC’s primary business is corrosion prevention marketed mainly under the ZERUST® brand. NTIC has been selling its proprietary ZERUST® rust and corrosion inhibiting products and services to the automotive, electronics, electrical, mechanical, military and retail consumer markets for over 35 years, and more recently, has targeted and expanded into the oil and gas industry. NTIC also sells a portfolio of bio-based and biodegradable (compostable) polymer resin compounds and finished products marketed under the Natur-Tec® brand. These products are intended to reduce NTIC’s customers’ carbon footprint and provide environmentally sound disposal options.

NTIC’s ZERUST® rust and corrosion inhibiting products include plastic and paper packaging, liquids and coatings, rust removers and cleaners, diffusers and variations of these products designed specifically for the oil and gas industry. NTIC’s also offers worldwide on-site technical consulting for rust and corrosion prevention issues. NTIC’s technical service consultants work directly with the end users of NTIC’s ZERUST® rust and corrosion inhibiting products to analyze their specific needs and develop systems to meet their technical requirements. In North America, NTIC sells its ZERUST® corrosion prevention solutions through a direct sales force as well as a network of independent distributors and agents. Internationally, NTIC sells its ZERUST® corrosion prevention solutions through its majority owned Brazilian subsidiary, Zerust Prevenção de Corrosão S.A. (Zerust Brazil), its majority owned joint venture holding company for NTIC’s joint venture investments in the Association of Southeast Asian Nations (ASEAN) region, and joint venture arrangements in North America and Europe.

One of NTIC’s strategic initiatives is to expand into and penetrate other markets for its ZERUST® corrosion prevention solutions. For the past several years, NTIC has focused its sales and marketing efforts on the oil and gas industry since the infrastructure that supports that industry is typically constructed using metals that are highly susceptible to corrosion and NTIC believes that its ZERUST® corrosion prevention solutions will minimize maintenance downtime on critical oil and gas industry infrastructure, extend the life of such infrastructure and reduce the risk of environmental pollution due to corrosion leaks.

Petroleo Brasileiro S.A. (Petrobras), an oil company located in Brazil, has conducted extensive multi-year product field trials of NTIC’s ZERUST® rust and corrosion inhibiting products against competitive alternatives. During fiscal 2010, Zerust Brazil received a Phase 1 contract for an initial implementation of \$1.4 million in ZERUST® products which was delivered in fiscal 2010 and fiscal 2011. During fiscal 2011, Zerust Brazil signed a Phase 2 contract with Petrobras to supply \$2.4 million in ZERUST® products. During fiscal 2012, Petrobras expanded this Phase 2 contract to supply an additional \$657,000 in ZERUST® products, bringing the total Phase 2 contract value to \$3.1 million in ZERUST® products, which were delivered in fiscal 2012. During first quarter of fiscal 2013, Zerust Brazil signed a Phase 3 contract with Petrobras to supply \$3.7 million in ZERUST® products.

NTIC is also pursuing opportunities to market its ZERUST® rust and corrosion prevention solutions to other targeted potential customers in the oil and gas industry across several countries through NTIC's joint venture partners and other strategic partners. NTIC believes the sale of its ZERUST® corrosion prevention solutions to customers in the oil and gas industry will involve a long sales cycle, likely including a one- to two-year trial period with each customer and a slow integration process thereafter.

Natur-Tec® bio-based and biodegradable plastics are manufactured using NTIC's patented and/or proprietary technologies and are intended to replace conventional petroleum-based plastics. The Natur-Tec® bioplastics portfolio includes biopolymer resin compounds which are available in several grades tailored for a variety of applications, such as blown-film extrusion, extrusion coating, injection molding and rigid, engineered plastics, and finished products, including shopping and grocery bags, lawn and leaf bags, can liners, pet waste collection bags, cutlery, packaging foam and coated paper products, which are engineered to be fully biodegradable in a composting environment. In North America, NTIC markets its Natur-Tec® resin compounds and finished products primarily through a network of national and regional distributors and independent agents. NTIC continues to see significant opportunities for finished bioplastic products and, therefore, continues to strengthen and expand its North American distribution network for finished Natur-Tec® bioplastic products. Internationally, NTIC sells its Natur-Tec® resin compounds and finished products both directly and through some of its joint venture arrangements, including in particular its joint venture in India, Harita NTI Limited (HNTI).

During fiscal 2012, HNTI and a major global apparel brand entered into an agreement for the supply by HNTI of compostable packaging for branded garments. In addition, HNTI is pursuing applications for bioplastics in food and personal care product packaging through alliances with several local partners in India. During fiscal 2011, NTIC entered into an agreement with Italy-based Naturfuels s.r.l. to distribute its Natur-Tec® bioplastic materials and products in the Italian market. Under the terms of the distribution agreement, NTIC supplies Naturfuels with NTIC's patented high-strength Natur-Tec® compostable film grade resin compounds to be used for the production of bio-plastic shopping and garbage bags on conventional plastic film production equipment. In 2011, the Italian government passed legislation banning the use of non-biodegradable plastic shopping bags. However, enforcement of this law has recently been delayed to allow Italian bag manufacturers to exhaust their current supply of conventional polyolefinic resins before completely changing to certified compostable resins. As a result, resin sales to Naturfuels are not expected to have a material effect on NTIC's operating results until mid-fiscal 2013.

### **NTIC's Joint Venture Network**

NTIC participates in 23 active joint venture arrangements in North America, Europe and Asia. Each of these joint ventures generally manufactures and markets products in the geographic territory to which it is assigned. While most of NTIC's joint ventures exclusively sell rust and corrosion inhibiting products, some of the joint ventures sell NTIC's Natur-Tec® resin compounds. NTIC historically has funded its investments in joint ventures with cash generated from operations.

NTIC's receipt of funds from its joint ventures is dependent upon fees for services that NTIC provides to its joint ventures, based primarily on the revenues of the joint ventures, and NTIC's receipt of dividend distributions from the joint ventures. NTIC receives fees for services provided to its joint ventures based primarily on the net sales of the individual joint ventures. The fees for services provided to joint ventures are determined based on either a flat fee or a percentage of sales depending on local laws and tax regulations. With respect to NTIC's primary joint venture in Germany (EXCOR), NTIC recognizes an agreed upon quarterly fee for such services. NTIC recognizes equity income from its joint ventures based on the overall profitability of its joint ventures. Such profitability is subject to variability from quarter to quarter which, in turn, subjects NTIC's earnings to variability from quarter to quarter. The profits of NTIC's joint ventures are shared by the respective joint venture owners in accordance with their respective ownership percentages. NTIC typically owns only 50% or less of each of its joint venture entities and thus does not control the decisions of these entities regarding whether to pay dividends and, if paid, how much they should be in a given year. The payment of a dividend by an entity is determined by a joint vote of the owners and is not at the sole discretion of NTIC.

NTIC does not consolidate the results of its 23 joint ventures in its consolidated financial statements. NTIC's investments in its joint ventures are accounted for using the equity method. Although Zerust Brazil originated as a joint venture of NTIC, it is no longer considered a joint venture, but rather it is a majority owned subsidiary of NTIC; and thus, unlike NTIC's joint ventures, its results are consolidated in NTIC's consolidated financial statements. NTIC holds 85% of the equity and 85% of the voting rights of Zerust Brazil.

In addition, beginning in the first quarter of fiscal 2013, NTIC has consolidated the results of NTI Asean, which effective as of September 1, 2012 is a majority owned subsidiary of NTIC. On September 1, 2012, NTIC and the other 50% owner in NTI Asean contributed their respective shares of capital stock of Korea Zerust Co., Ltd. (Korea Zerust), constituting an aggregate of 50% of the equity and voting rights of Korea Zerust, to NTI Asean, and NTIC contributed exclusive license rights and other intellectual property to NTI Asean in exchange for an additional 10% ownership interest in NTI Asean. As a result of such transaction, NTIC holds 60% of the equity and 60% of the voting rights of NTI Asean. NTI Asean holds investments in eight entities that operate in the following eight territories located in the Association of Southeast Asian Nations (ASEAN) region: China, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand. With respect to NTIC's joint ventures, NTIC considers only EXCOR and China to be individually significant to NTIC's consolidated assets and income; and therefore, provides certain additional information regarding EXCOR and China in the notes to NTIC's consolidated financial statements and in this section of this report.

## **Financial Overview**

NTIC's management, including its chief executive officer who is NTIC's chief operating decision maker, reports and manages NTIC's operations in two reportable business segments based on products sold, customer base and distribution center: ZERUST® products and services and Natur-Tec® products.

NTIC's consolidated net sales increased 9.5% during the three months ended November 30, 2012 compared to the three months ended November 30, 2011. This increase was primarily a result of increased sales of Natur-Tec® products and ZERUST® rust and corrosion inhibiting packaging products and services. During the three months ended November 30, 2012, 90.6% of NTIC's consolidated net sales were derived from sales of ZERUST® products and services, which increased 7.7% to \$4,795,283 during the three months ended November 30, 2012, compared to the same respective prior fiscal year period due to increased demand from existing customers and the addition of new customers. NTIC has focused its sales efforts of ZERUST® products and services by strategically targeting customers with specific corrosion issues in new market areas, including the oil and gas industry and other industrial sectors that offer sizable growth opportunities. NTIC's consolidated net sales for the three months ended November 30, 2012 included \$551,814 of sales made by Zerust Brazil, and of those sales, \$40,385 in sales were made to the oil and gas industry sector in Brazil. Overall demand for ZERUST® products and services depends heavily on the overall health of the markets in which NTIC sells its products, including in particular the automotive market.

During the three months ended November 30, 2012, 9.4% of NTIC's consolidated net sales were derived from sales of Natur-Tec® products compared to 7.9% during the three months ended November 30, 2011. Net sales of Natur-Tec® products increased 30.8% during the three months ended November 30, 2012 compared to the three months ended November 30, 2011. This increase was due to increased sales to Natur-Tec® distributors in the United States as NTIC has continued to strengthen and expand its U.S. industrial distribution. Additionally, NTIC has continued to target key national and regional retailers utilizing independent sales agents. Demand for the Natur-Tec® products depends primarily on market acceptance and the extent of NTIC's distribution network.

Cost of goods sold as a percentage of net sales increased to 69.8% during the three months ended November 30, 2012 compared to 66.4% during the three months ended November 30, 2011 primarily as a result of increased production expense associated with the production and shipping of both ZERUST® and Natur Tec® products. The increases are considered temporary as new suppliers are being implemented for new products and applications.

NTIC's equity in income of joint ventures decreased 15.0% to \$1,154,296 during the three months ended November 30, 2012 compared \$1,357,680 during the three months ended November 30, 2011 primarily as a result of the consolidation of NTI Asean which was included in the current fiscal quarter, but not in the prior comparative quarter.

NTIC recognized a 27.7% increase in fees for services provided to joint ventures during the three months ended November 30, 2012 compared to the three months ended November 30, 2011. This increase was primarily a result of the consolidation of fees for services earned by NTI Asean which are included in the current fiscal quarter, but not in the prior comparative quarter. This is partially offset by a 4.4% decrease in total net sales of NTIC's joint ventures to \$27,524,934 during the three months ended November 30, 2012 compared to \$28,795,232 for the three months ended November 30, 2011. Total net sales of NTIC's joint ventures were adversely affected in part by the European economic slowdown, which NTIC believes adversely affected the net sales of NTIC's European joint ventures as well as certain of NTIC's other non-European joint ventures, and the weakening of the EURO and other currencies compared to the U.S. dollar.

NTIC's total operating expenses increased to \$3,727,684 during the three months ended November 30, 2012 compared to \$3,393,068 for the three months ended November 30, 2011. This increase was primarily the result of an increase in selling expenses, general and administrative expenses and expenses incurred in support of joint ventures, research and development expenses, and overall reflected NTIC's efforts to support its new business efforts.

NTIC expenses all costs related to product research and development as incurred. NTIC incurred \$938,206 and \$814,305 of expense during the three months ended November 30, 2012 and 2011, respectively, in connection with its research and development activities. These represent net amounts after being reduced by reimbursements related to certain research and development contracts. Such reimbursement totaled \$68,682 during the three months ended November 30, 2012 and 2011. NTIC anticipates that it will spend between \$3,800,000 and \$4,000,000 in total during fiscal 2013 on research and development activities related to its new technologies. This estimate is a net range after being reduced by anticipated reimbursements related to certain research and development contracts.

Net income attributable to NTIC decreased 59.4% to \$389,622, or \$0.09 per diluted common share, for the three months ended November 30, 2012 compared to \$958,757, or \$0.22 per diluted common share, for the three months ended November 30, 2011. This decrease was primarily the result of decreases in gross profits of NTIC's North American businesses as well as decreases in sales and earnings of NTIC's subsidiary in Brazil. NTIC anticipates that its quarterly net income will remain subject to significant volatility primarily due to the financial performance of its joint ventures and sales of its ZERUST® products and services into the oil and gas industry and Natur-Tec® bioplastics products, which sales fluctuate more on a quarterly basis than the traditional ZERUST® business.

NTIC's working capital was \$15,306,871 at November 30, 2012, including \$6,819,036 in cash and cash equivalents compared to \$10,060,081 at August 31, 2012, including \$4,137,547 in cash and cash equivalents.

## Results of Operations

The following tables set forth NTIC's results of operations for the three months ended November 30, 2012 and 2011.

	Three Months Ended					
	November 30, 2012	% of Net Sales	November 30, 2011	% of Net Sales	\$ Change	% Change
Net sales, excluding joint ventures	\$ 4,770,387	90.1%	\$ 4,277,643	88.5%	\$ 492,744	11.5%
Net sales, to joint ventures	521,360	9.9%	554,471	11.5%	(33,111)	(6.0)%
Cost of goods sold	3,690,972	69.8%	3,209,476	66.4%	481,496	15.0%
Equity in income of joint ventures	1,154,296	21.8%	1,357,680	28.1%	(203,384)	(15.0)%
Fees for services provided to joint ventures	1,846,277	34.9%	1,445,252	29.9%	401,025	27.7%
Selling expenses	1,171,095	22.1%	1,108,486	22.9%	62,609	5.6%
General and administrative expenses	1,248,696	23.6%	1,270,013	26.3%	(21,317)	(1.7)%
Expenses incurred in support of joint ventures	369,687	7.0%	200,264	4.1%	169,423	84.6%
Research and development expenses	938,206	17.7%	814,305	16.9%	\$ 123,901	15.2%

*Net Sales.* NTIC's consolidated net sales increased 9.5% to \$5,291,747 during the three months ended November 30, 2012 compared to the three months ended November 30, 2011. NTIC's consolidated net sales to unaffiliated customers excluding NTIC's joint ventures increased 11.5% to \$4,770,387 during the three months ended November 30, 2012 compared to the same respective prior fiscal year period. This increase was primarily a result of increased sales of Natur-Tec® products and ZERUST® rust and corrosion inhibiting packaging products and services. Net sales to joint ventures decreased 6.0% to \$521,360 during the three months ended November 30, 2012 compared to the same respective prior fiscal year period. This decrease correlated with the 4.4% decrease in total net sales of NTIC's joint ventures for the three months ended November 30, 2012.

The following table sets forth NTIC's net sales by product category for the three months ended November 30, 2012 and 2011 by segment:

	Three Months Ended	
	November 30, 2012	November 30, 2011
ZERUST® sales	\$ 4,795,283	\$ 4,452,646
Natur-Tec® sales	496,464	379,468
Total net sales	\$ 5,291,747	\$ 4,832,114

During the three months ended November 30, 2012, 90.6% of NTIC's consolidated net sales were derived from sales of ZERUST® products and services, which increased 7.7% to \$4,795,283 during the three months ended November 30, 2012 compared to \$4,452,646 during the same prior year period, due primarily from increased demand from existing customers and the addition of new customers. NTIC has focused its sales efforts of ZERUST® products and services by strategically targeting customers with specific corrosion issues in new market areas, including the oil and gas industry and other industrial sectors that offer sizable growth opportunities.

NTIC's consolidated net sales during the three months ended November 30, 2012 included \$551,814 of sales made by Zerust Brazil, and of those sales, \$40,385 in sales were made to the oil and gas industry sector in Brazil.

During the three months ended November 30, 2012, 9.4% of NTIC's consolidated net sales, respectively, were derived from sales of Natur-Tec® products, which increased 30.8% to \$496,464 during the three months ended November 30, 2012 compared to the three months ended November 30, 2011. This increase was due to increased sales to Natur-Tec® distributors on the West Coast of the United States as NTIC has continued to strengthen and expand its U.S. industrial distribution. Additionally, NTIC has continued to target key national and regional retailers utilizing independent sales agents. Demand for the Natur-Tec® products depends primarily on market acceptance and the extent of NTIC's distribution network.

*Cost of Goods Sold.* Cost of goods sold increased 15.0% for the three months ended November 30, 2012 compared to the three months ended November 30, 2011 primarily as a result of increased net sales as described above as well as the increase in production and shipping costs associated with ZERUST® products. Cost of goods sold as a percentage of net sales increased to 69.7% for the three months ended November 30, 2012 compared to 66.4% for the three months ended November 30, 2011 primarily as a result of the increase in production and shipping costs associated with ZERUST® products.

*Equity in Income of Joint Ventures.* NTIC's equity in income of joint ventures decreased 15.0% to \$1,154,296 during the three months ended November 30, 2012 compared \$1,357,680 during the three months ended November 30, 2011 primarily as a result of the consolidation of NTI Asean in the current fiscal year quarter, but not in the prior fiscal year comparative quarter. Of the total equity in income of joint ventures, NTIC had equity in income of joint ventures of \$785,187 attributable to EXCOR during the three months ended November 30, 2012 compared to \$728,528 attributable to EXCOR and \$147,001 attributable to China during the three months ended November 30, 2011. NTIC had equity in income of joint ventures of \$147,001 attributable to its joint venture in China during the three months ended November 30, 2012. NTIC had equity in income of all other joint ventures of \$222,108 during the three months ended November 30, 2012 compared to \$259,691 during the three months ended November 30, 2011.

*Fees for Services Provided to Joint Ventures.* NTIC recognized fee income for services provided to joint ventures of \$1,846,277 during the three months ended November 30, 2012 compared to \$1,445,252 during the three months ended November 30, 2011 representing an increase of \$401,025. This increase was primarily a result consolidation of the fees for services earned by NTI Asean which are included in the current fiscal quarter, but not in the prior comparative quarter. This is partially offset by a 4.4% decrease in total net sales of NTIC's joint ventures to \$27,524,934 during the three months ended November 30, 2012 compared to \$28,795,232 for the three months ended November 30, 2011. Total net sales of NTIC's joint ventures were adversely affected in part by the European economic slowdown, which NTIC believes also adversely affected net sales of certain of NTIC's other non-European joint ventures, as well as the weakening of the EURO and other currencies compared to the U.S. dollar. Sales of NTIC's joint ventures are not included in NTIC's product sales and are not combined with NTIC's sales in NTIC's consolidated financial statements or in any description of NTIC's sales.

Of the total fee income for services provided to its joint ventures, fees of \$493,312 and \$242,700 were attributable to NTIC's joint venture in China and EXCOR, respectively, during the three months ended November 30, 2012 compared to \$249,447 attributable to EXCOR during the three months ended November 30, 2011. This decrease was the result of foreign currency exchange rate fluctuations.

*Selling Expenses.* NTIC's selling expenses increased 5.6% for the three months ended November 30, 2012 compared to the same respective period in fiscal 2012 due to increases in compensation and employee benefits, lab testing related expenses, commission expenses, travel and related expenses, and consulting expenses and selling expenses incurred at Zerust Brazil. Selling expenses as a percentage of net sales decreased slightly to 22.1% for the three months ended November 30, 2012, from 22.9% during the three months ended November 30, 2011, due primarily to the increase in net sales, partially offset by the increase in selling expenses as previously described.

*General and Administrative Expenses.* NTIC's general and administrative expenses decreased 1.7% for the three months ended November 30, 2012 compared to the same respective periods in fiscal 2011 due to a decrease in consulting expenses. As a percentage of net sales, general and administrative expenses decreased to 23.6% for the three months ended November 30, 2012 from 26.3% for the three months ended November 30, 2011.

*Expenses Incurred in Support of Joint Ventures.* Expenses incurred in support of NTIC's joint ventures were \$369,687 during the three months ended November 30, 2012 compared to \$200,264 during the three months ended November 30, 2011, representing an increase of 84.6%. This increase was due primarily to increased compensation and benefits expenses associated with increased headcount.

*Research and Development Expenses.* NTIC's research and development expenses increased 15.2% for the three months ended November 30, 2012 compared to the same respective periods in fiscal 2011. The increase was primarily due to compensation and benefit expenses associated with increased headcount and an increase in consulting expenses, partially offset by reimbursements related to certain research and development contracts.

*Interest Income.* NTIC's interest income increased to \$25,346 during the three months ended November 30, 2012 compared to \$8,060 during the three months ended November 30, 2011 primarily due to increased cash balances earning interest during the most recent periods.

*Interest Expense.* NTIC's interest expense decreased to \$6,474 during the three months ended November 30, 2012 compared to \$5,966 during the three months ended November 30, 2011.

*Income Before Income Tax Expense.* Income before income tax expense decreased to \$892,536 for the three months ended November 30, 2012 compared to \$1,041,421 for the three months ended November 30, 2011.

*Income Tax Expense.* Income tax expense was \$134,000 during the three months ended November 30, 2012 compared \$106,000 during the three months ended November 30, 2011. Income tax expense was calculated based on management's estimate of NTIC's annual effective income tax rate. NTIC's annual effective income tax rate during the three months ended November 30, 2012 and 2011 was lower than the statutory rate primarily due to NTIC's equity in income of joint ventures being recognized based on after-tax earnings of these entities. To the extent undistributed earnings of NTIC's joint ventures are distributed to NTIC, it is not expected to result in any material additional income tax liability after the application of foreign tax credits. NTIC records a tax valuation allowance when it is more likely than not that some portion or all of its deferred tax assets will not be realized to reduce deferred tax assets to the amount expected to be realized. NTIC determined based on all available evidence, including historical data and projections of future results, that it is more likely than not that all of its deferred tax assets, except for its foreign tax credit carryforwards and Minnesota state research and development credit carryforwards, will be fully realized. In addition, NTIC determined based upon all available evidence, including new IRS guidance, historical results, projected future taxable income and foreign tax credit utilization, that it was not more likely than not that the federal research and development credits would be utilized during the carryforward period and as a result, a valuation allowance was recorded against all of NTIC's federal research and development credits. In addition, NTIC continues to believe that its deferred tax asset related to foreign tax credit carryforwards will not be realized due to insufficient federal taxable income within the carryforward period and the fact that for ordering purposes the foreign tax credit carryforwards are not allowed to be used until after any current year foreign tax credits are utilized.

NTIC considers the earnings of certain foreign joint ventures to be indefinitely invested outside the United States on the basis of estimates that future domestic cash generation will be sufficient to meet future domestic cash needs. As a result, U.S. income and foreign withholding taxes have not been recognized on the cumulative undistributed earnings of \$19.3 million and \$19.4 million at November 30, 2012 and August 31, 2012, respectively. To the extent undistributed earnings of NTIC's joint ventures are distributed in the future, they are not expected to result in any material additional income tax liability after the application of foreign tax credits.

*Other Comprehensive Income - Foreign Currency Translations Adjustment.* The volatility of the foreign currency translations adjustment was due to the volatility of the U.S. Dollar compared to the Euro and other foreign currencies during the three months ended November 30, 2012 compared to the same respective period in fiscal 2011.

## **Liquidity and Capital Resources**

*Sources of Cash and Working Capital.* As of November 30, 2012, NTIC's working capital was \$15,306,871, including \$6,819,036 in cash and cash equivalents, compared to working capital of \$10,060,081, including \$4,137,547 in cash and cash equivalents, at August 31, 2012.

As of November 30, 2012, NTIC had a term loan with a principal amount of \$990,503 outstanding that Northern Technologies Holding Company, LLC (NTI LLC) obtained from PNC Bank, National Association (PNC Bank) in connection with the purchase of NTIC's corporate headquarters in September 2006. The term loan matures on January 10, 2016, bears interest at an annual rate based on the daily LIBOR rate plus 2.15% and is payable in consecutive monthly installments equal to approximately \$6,343 (inclusive of principal but exclusive of interest). The term loan is secured by a first lien on the real estate and building owned by NTI LLC and all of the assets of NTIC and is guaranteed by NTIC.

As of November 30, 2012, NTIC also had a revolving line of credit with PNC Bank of \$3,000,000 with no amounts outstanding as of such date. The line of credit is evidenced by an amended and restated committed line of credit note in the principal amount of up to \$3,000,000. The line of credit has a \$1,200,000 standby letter of credit subfacility, with any standby letters of credit issued thereunder being at the sole discretion of PNC Bank. Any standby letters of credit issued under the subfacility are subject to customary fees and charges payable by NTIC. At the option of NTIC, outstanding advances under the line of credit bear interest at either (a) an annual rate based on LIBOR plus 2.15% for the applicable LIBOR interest period selected by NTIC or (b) at the rate publicly announced by PNC Bank from time to time as its prime rate. Interest is payable in arrears (a) for the portion of advances bearing interest under the prime rate on the last day of each month during the term thereof and (b) for the portion of advances bearing interest under the LIBOR option on the last day of the respective LIBOR interest period selected for such advance. Any unpaid interest is payable on the maturity date. As of November 30, 2012, the interest rate on the line of credit was 3.20%.

The term loan and the line of credit are governed under two separate loan agreements. The loan agreements contain standard covenants, including affirmative financial covenants, such as the maintenance of a minimum fixed charge coverage ratio, and negative covenants, which, among other things, limit the incurrence of additional indebtedness, loans and equity investments, disposition of assets, mergers and consolidations and other matters customarily restricted in such agreements. Under the loan agreements, NTIC is subject to a minimum fixed charge coverage ratio of 1.10:1.00.

On December 11, 2012, PNC Bank extended the maturity date of the line of credit from January 9, 2013 to January 8, 2014 and waived a technical covenant default by NTIC to deliver quarterly compliance certificates. All other terms of the line of credit and the loan agreement and other documents evidencing the line of credit remain the same. NTIC expects to remain in compliance with all loan agreement covenants during the remainder of fiscal 2013.

NTIC believes that a combination of its existing cash and cash equivalents, forecasted cash flows from future operations, anticipated distributions of earnings, anticipated fees to NTIC for services provided to its joint ventures, and funds available through existing or anticipated financing arrangements, will be adequate to fund its existing operations, investments in new or existing joint ventures, capital expenditures, debt repayments and any stock repurchases for at least the next 12 months. During the remainder of fiscal 2013, NTIC expects to continue to invest in research and development and in marketing efforts and resources into the application of its corrosion prevention technology into the oil and gas industry and its Natur-Tec<sup>®</sup> bio-plastics business. In order to take advantage of such new product and market opportunities to expand its business and increase its revenues, NTIC may decide to finance such opportunities by borrowing under its revolving line of credit or raising additional financing through the issuance of debt or equity securities. There is no assurance that any financing transaction will be available on terms acceptable to NTIC or at all, or that any financing transaction will not be dilutive to NTIC's current stockholders.

NTIC traditionally has used the cash generated from its operations, distributions of earnings and fees for services provided to its joint ventures to fund NTIC's new technology investments and capital contributions to new and existing joint ventures. NTIC's joint ventures traditionally have operated with little or no debt and have been self-financed with minimal initial capital investment and minimal additional capital investment from their respective owners. Therefore, NTIC believes it is not likely that there exists any exposure to debt by NTIC's joint ventures that could materially impact their respective operations and/or liquidity.

*Uses of Cash and Cash Flows.* Net cash used in operating activities during the three months ended November 30, 2012 was \$1,474,140, which resulted principally from NTIC's equity in income from joint ventures and increases in receivables, inventories and prepaid expenses and a decrease in accounts payables, accrued liabilities and income taxes payable, partially offset by NTIC's net income, depreciation and amortization. Net cash used in operating activities during the three months ended November 30, 2011 was \$1,785,543 which resulted principally from NTIC's equity in income from joint ventures and increases in receivables, inventories and prepaid expenses, and decreases in payables and accrued liabilities partially offset by NTIC's net income, depreciation, amortization and income taxes payable.

NTIC's cash flows from operations are impacted by significant changes in certain components of NTIC's working capital, including inventory turnover and changes in receivables. NTIC considers internal and external factors when assessing the use of its available working capital, specifically when determining inventory levels and credit terms of customers. Key internal factors include existing inventory levels, stock reorder points, customer forecasts and customer requested payment terms, and key external factors include the availability of primary raw materials and sub-contractor production lead times. NTIC's typical contractual terms for trade receivables excluding joint ventures are traditionally 30 days and for trade receivables from its joint ventures are 90 days. Before extending unsecured credit to customers, excluding NTIC's joint ventures, NTIC reviews customers' credit histories and will establish an allowance for uncollectible accounts based upon factors surrounding the credit risk of specific customers and other information. Accounts receivable over 30 days are considered past due for most customers. NTIC does not accrue interest on past due accounts receivable. If accounts receivable in excess of the provided allowance are determined uncollectible, they are charged to selling expense in the period that determination is made. Accounts receivable are deemed uncollectible based on NTIC exhausting reasonable efforts to collect. NTIC's typical contractual terms for receivables for services provided to its joint ventures are 90 days. NTIC records receivables for services provided to its joint ventures on an accrual basis, unless circumstances exist that make the collection of the balance uncertain in which case the fee income will be recorded on a cash basis until there is consistency in payments. This determination is handled on a case by case basis.

NTIC experienced an increase in receivables and inventory as of November 30, 2012 compared to August 31, 2012 due to the increase in net sales and a desire to stock more products to shorten lead times and anticipate customer demand. Trade receivables excluding joint ventures as of November 30, 2012 increased \$167,278 compared to August 31, 2012, primarily related to the increase in NTIC's net sales.

Outstanding trade receivables excluding joint ventures balances as of November 30, 2012 increased 1 day to an average of 51 days from balances outstanding from these customers as of August 31, 2012.

Outstanding trade receivables from joint ventures as of November 30, 2012 increased \$207,957 compared to August 31, 2012 primarily due to the timing of payments, which resulted in an increase of outstanding balances from trade receivables from joint ventures as of November 30, 2012 of 164 days from an average of 130 days from balances outstanding from these customers compared to August 31, 2012. The significant average days outstanding of trade receivables from joint ventures as of November 30, 2012 were primarily due to the receivable balance at NTIC's joint venture in India and to a lesser extent NTIC's joint venture in China.

Outstanding receivables for services provided to joint ventures as of November 30, 2012 increased \$1,011,522 compared to August 31, 2012, primarily resulting from the consolidation of NTI Asean which resulted in an increase of 9 days of fees receivable outstanding as of November 30, 2012 to an average of 115 days compared to August 31, 2012.

Net cash provided by investing activities for the three months ended November 30, 2012 was \$4,153,275, which was comprised of dividends received from joint ventures partially offset by additions to property and equipment and additions to patents and effect of the NTI Asean consolidation on cash of \$1,612,768. Net cash provided by investing activities for the three months ended November 30, 2011 was \$1,935,717, which was comprised of dividends received from joint ventures partially offset by additions to property and equipment, additions to patents and investments in joint ventures.

Net cash provided by financing activities for the three months ended November 30, 2012 was \$39,881, which resulted from proceeds from NTIC's employee stock purchase plan and, to a lesser extent, option exercises and, partially offset by principal payments on the bank loan for NTIC's corporate headquarters buildings. Net cash provided by financing activities for the three months ended November 30, 2011 was \$3,385, which resulted from proceeds from option exercises and, to a lesser extent, NTIC's employee stock purchase plan, partially offset by principal payments on the bank loan for NTIC's corporate headquarters buildings.

*Capital Expenditures and Commitments.* NTIC had no material lease or other material capital commitments as of November 30, 2012, except a lease agreement entered into by NTI Facilities, Inc., a subsidiary of NTIC, for 16,994 square feet of office, manufacturing, laboratory and warehouse space in Beachwood, Ohio, requiring monthly payments of \$17,500, which are adjusted annually according to the annual consumer price index, through November 2014.

NTIC spent \$67,165 on capital expenditures during the three months ended November 30, 2012 and expects to spend an aggregate of approximately \$1,000,000 on capital expenditures during fiscal 2013. Such anticipated capital expenditures for fiscal 2013 relate primarily to the expansion of its laboratory facilities in Circle Pines, Minnesota and the purchase of new equipment.

#### **Off-Balance Sheet Arrangements**

NTIC does not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet financial arrangements. As such, NTIC is not materially exposed to any financing, liquidity, market or credit risk that could arise if NTIC had engaged in such arrangements.

#### **Inflation and Seasonality**

Inflation in the U.S. and abroad historically has had little effect on NTIC. NTIC's business has not historically been seasonal.

#### **Market Risk**

NTIC is exposed to some market risk stemming from changes in foreign currency exchange rates, commodity prices and interest rates.

Because the functional currency of NTIC's foreign operations and investments in its foreign joint ventures is the applicable local currency, NTIC is exposed to foreign currency exchange rate risk arising from transactions in the normal course of business. NTIC's principal exchange rate exposure is with the Euro, the Japanese yen, Indian Rupee, Chinese yuan, Korean won and the English pound against the U.S. dollar. NTIC's fees for services provided to joint ventures and dividend distributions from these foreign entities are paid in foreign currencies and thus fluctuations in foreign currency exchange rates could result in declines in NTIC's reported net income. Since NTIC's investments in its joint ventures are accounted for using the equity method, any changes in foreign currency exchange rates would be reflected as a foreign currency translation adjustment and would not change NTIC's equity in income of joint ventures reflected in its consolidated statements of income. NTIC does not hedge against its foreign currency exchange rate risk.

Some raw materials used in NTIC's products are exposed to commodity price changes. The primary commodity price exposures are with a variety of plastic resins.

At the option of NTIC, outstanding advances under NTIC's \$3,000,000 revolving line of credit with PNC Bank bear interest at either (a) an annual rate based on LIBOR plus 2.15% for the applicable LIBOR interest period selected by NTIC or (b) at the rate publicly announced by PNC Bank from time to time as its prime rate, and thus may subject NTIC to some market risk on interest rates. As of November 30, 2012, NTIC had no borrowings under the line of credit.

### **Critical Accounting Policies and Estimates**

There have been no material changes to NTIC's critical accounting policies and estimates from the information provided in "Part II. Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies", included in NTIC's annual report on Form 10-K for the fiscal year ended August 31, 2012, except for the following:

#### ***Principles of Consolidation***

NTIC evaluates its voting and variable interests in entities on a qualitative and quantitative basis. NTIC consolidates entities in which it concludes it has the power to direct the activities that most significantly impact an entity's economic success and has the obligation to absorb losses or the right to receive benefits that could be significant to the entity. All such relationships are evaluated on an ongoing basis. The consolidated financial statements include the accounts of Northern Technologies International Corporation, its wholly owned subsidiaries, NTI Facilities, Inc., Northern Technologies Holding Company, LLC and NTIC's majority owned subsidiary in Brazil, Zerust Prevenção de Corrosão S.A., and NTIC's majority owned holding company, NTI Asean LLC. NTIC's consolidated financial statements do not include the accounts of any of its joint ventures. NTIC's consolidated financial statements do not include Polymer Energy LLC, in which NTIC holds a 62.5% ownership interest. Polymer Energy LLC had immaterial activity in fiscal 2012 and fiscal 2011.

#### **Recent Accounting Pronouncements**

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, "*Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS)*." This pronouncement was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and IFRS. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. This pronouncement is effective for reporting periods beginning on or after December 15, 2011, with early adoption prohibited. The new guidance will require prospective application. NTIC adopted this guidance beginning in the first quarter of fiscal 2013. Adoption of this guidance did not have a material impact on NTIC's consolidated results of operations or financial position.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220), Presentation of Comprehensive Income*. The guidance requires an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. Companies will no longer be permitted to present components of other comprehensive income solely in the statements of stockholders' equity. NTIC adopted ASU 2011-05 beginning in the first quarter of fiscal 2013 and has made the appropriate disclosures in the consolidated financial statements.

Although there are several other new accounting pronouncements issued or proposed by the FASB, which NTIC has adopted or will adopt, as applicable, NTIC does not believe any of these accounting pronouncements has had or will have a material impact on NTIC's consolidated financial position or operating results.

## Forward-Looking Statements

This quarterly report on Form 10-Q contains not only historical information, but also forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by those sections. In addition, NTIC or others on NTIC's behalf may make forward-looking statements from time to time in oral presentations, including telephone conferences and/or web casts open to the public, in press releases or reports, on NTIC's Internet web site or otherwise. All statements other than statements of historical facts included in this report or expressed by NTIC orally from time to time that address activities, events or developments that NTIC expects, believes or anticipates will or may occur in the future are forward-looking statements including, in particular, the statements about NTIC's plans, objectives, strategies, the outcome of contingencies such as legal proceedings, and prospects regarding, among other things, NTIC's financial condition, results of operations and business. NTIC has identified some of these forward-looking statements in this report with words like "believe," "may," "could," "would," "might," "forecast," "possible," "potential," "project," "will," "should," "expect," "intend," "plan," "predict," "anticipate," "estimate," "approximate" "outlook" or "continue" or the negative of these words or other words and terms of similar meaning. The use of future dates is also an indication of a forward-looking statement. Forward-looking statements may be contained in the notes to NTIC's consolidated financial statements and elsewhere in this report, including under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Forward-looking statements are based on current expectations about future events affecting NTIC and are subject to uncertainties and factors that affect all businesses operating in a global market as well as matters specific to NTIC. These uncertainties and factors are difficult to predict and many of them are beyond NTIC's control. The following are some of the uncertainties and factors known to us that could cause NTIC's actual results to differ materially from what NTIC has anticipated in its forward-looking statements:

- The effect of current worldwide economic conditions, the European sovereign debt crisis and turmoil and disruption in the global credit and financial markets on NTIC's business;
- The health of the U.S. automotive industry on NTIC's business;
- NTIC's dependence on the success of its joint ventures and fees and dividend distributions that NTIC receives from them;
- NTIC's relationships with its joint ventures and its ability to maintain those relationships, especially in light of anticipated succession planning issues;
- The variability in NTIC's equity income of joint ventures, which in turn, subjects NTIC's earnings to quarterly fluctuations;
- Risks associated with NTIC's international operations and exposure to fluctuations in foreign currency exchange rates and import duties and taxes;
- Fluctuations in the cost and availability of raw materials, including resins and other commodities;

- The success of and risks associated with NTIC's emerging new businesses and products and services, including in particular NTIC's ability and the ability of NTIC's joint ventures to sell ZERUST® products and services into oil and gas industry and Natur-Tec® products and the often lengthy and extensive sales process involved in selling such products and services;
- NTIC's ability to introduce new products and services that respond to changing market conditions and customer demand;
- Market acceptance of NTIC's existing and new products, especially in light of existing and new competitive products;
- Maturation of certain existing markets for NTIC's ZERUST® products and services and NTIC's ability to grow market share and succeed in penetrating other existing and new markets;
- Increased competition, especially with respect to NTIC's ZERUST® products and services, and the effect of such competition on NTIC's and its joint ventures' pricing, net sales and margins;
- NTIC's reliance upon and its relationships with its distributors, independent sales representatives and joint ventures;
- NTIC's reliance upon suppliers, including in particular its single supply source for its base bioplastics resins;
- The costs and effects of complying with laws and regulations and changes in tax, fiscal, government and other regulatory policies, including rules relating to environmental, health and safety matters;
- The transition of the manufacturing of certain select ZERUST® rust and corrosion inhibiting products in house at NTIC's corporate headquarters location in Circle Pines, Minnesota;
- Unforeseen product quality or other problems in the development, production and usage of new and existing products;
- Loss of or changes in executive management or key employees;
- Ability of management to manage around unplanned events;
- NTIC's reliance on its intellectual property rights and the absence of infringement of the intellectual property rights of others;
- Fluctuations in NTIC's effective tax rate; and
- NTIC's reliance upon its management information systems.

For more information regarding these and other uncertainties and factors that could cause NTIC's actual results to differ materially from what NTIC has anticipated in its forward-looking statements or otherwise could materially adversely affect its business, financial condition or operating results, see NTIC's annual report on Form 10-K for the fiscal year ended August 31, 2012 under the heading "Part I. Item 1A. Risk Factors."

All forward-looking statements included in this report are expressly qualified in their entirety by the foregoing cautionary statements. NTIC wishes to caution readers not to place undue reliance on any forward-looking statement that speaks only as of the date made and to recognize that forward-looking statements are predictions of future results, which may not occur as anticipated. Actual results could differ materially from those anticipated in the forward-looking statements and from historical results, due to the uncertainties and factors described above, as well as others that NTIC may consider immaterial or does not anticipate at this time. Although NTIC believes that the expectations reflected in its forward-looking statements are reasonable, NTIC does not know whether its expectations will prove correct. NTIC's expectations reflected in its forward-looking statements can be affected by inaccurate assumptions NTIC might make or by known or unknown uncertainties and factors, including those described above. The risks and uncertainties described above are not exclusive and further information concerning NTIC and its business, including factors that potentially could materially affect its financial results or condition, may emerge from time to time. NTIC assumes no obligation to update, amend or clarify forward-looking statements to reflect actual results or changes in factors or assumptions affecting such forward-looking statements. NTIC advises you, however, to consult any further disclosures NTIC makes on related subjects in its annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K NTIC files with or furnishes to the Securities and Exchange Commission.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

This Item 3 is inapplicable to NTIC as a smaller reporting company and has been omitted pursuant to Item 305(e) of SEC Regulation S-K.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

NTIC maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) that are designed to provide reasonable assurance that information required to be disclosed by NTIC in the reports it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to NTIC's management, including NTIC's principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. NTIC's management evaluated, with the participation of its Chief Executive Officer and its Chief Financial Officer, the effectiveness of the design and operation of NTIC's disclosure controls and procedures as of the end of the period covered in this report. Based on that evaluation, NTIC's Chief Executive Officer and Chief Financial Officer concluded that NTIC's disclosure controls and procedures were effective as of the end of such period to provide reasonable assurance that information required to be disclosed in the reports that NTIC files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to NTIC's management, including NTIC's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

## **Changes in Internal Control over Financial Reporting**

There was no change in NTIC's internal control over financial reporting that occurred during the quarter ended November 30, 2012 that has materially affected, or is reasonably likely to materially affect NTIC's internal control over financial reporting, other than the consolidation of NTI Asean.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Not applicable.

**ITEM 1A. RISK FACTORS**

This Item 1A is inapplicable to NTIC as a smaller reporting company.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

**Recent Sales of Unregistered Equity Securities**

During the three months ended November 30, 2012, NTIC did not issue any shares of its common stock or other equity securities of NTIC that were not registered under the Securities Act of 1933, as amended.

**Issuer Purchases of Equity Securities**

During the three months ended November 30, 2012, NTIC did not purchase any shares of its common stock or other equity securities of NTIC.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

The following exhibits are being filed or furnished with this quarterly report on Form 10-Q:

<b>Exhibit No.</b>	<b>Description</b>
10.1	Waiver and Second Amendment to Loan Documents dated December 11, 2012 between Northern Technologies International Corporation and PNC Bank, National Association (filed herewith)
31.1	Certification of Chief Executive Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
31.2	Certification of Chief Financial Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)

<b>Exhibit No.</b>	<b>Description</b>
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)
101	The following materials from Northern Technologies International Corporation's Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the unaudited Consolidated Balance Sheets, (ii) the unaudited Consolidated Statements of Operations, (iii) the unaudited Consolidated Statements of Comprehensive Income, (iv) the unaudited Consolidated Statements of Cash Flows, and (v) Notes to Condensed Financial Statements (furnished herewith)*

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\* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this quarterly report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under Section 11 or 12 of the Securities Act of 1933, as amended, or otherwise subject to the liability of those sections, except as shall be expressly set forth by specific reference in such filings.

**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.

**NORTHERN TECHNOLOGIES INTERNATIONAL CORPORATION**



Date: January 14, 2013

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Matthew C. Wolsfeld, CPA  
Chief Financial Officer  
(Principal Financial and Accounting Officer and  
Duly Authorized to Sign on Behalf of the Registrant)

**NORTHERN TECHNOLOGIES INTERNATIONAL CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**

**EXHIBIT INDEX**

Exhibit No.	Description	Method of Filing
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\* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this quarterly report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under Section 11 or 12 of the Securities Act of 1933, as amended, or otherwise subject to the liability of those sections, except as shall be expressly set forth by specific reference in such filings.

PNC  
1900 East 9th Street  
Cleveland, OR 44114

December 11, 2012

Northern Technologies International Corporation  
4201 Woodland Road  
Circle Pines, MN 55014  
Attn: Matthew C. Wolsfeld

Re: Waiver to the Loan Agreement dated as of January 10, 2011 (as amended, the "Agreement") between NORTHERN TECHNOLOGIES INTERNATIONAL CORPORATION (the "Borrower") and PNC Bank, National Association (the "Bank")

Renewal of Expiration Date for \$3,000,000.00 Working Cash® Line of Credit

Dear Matthew:

This letter is issued in connection with the Agreement referenced above. Terms used in this letter which are defined in the Agreement shall have the same meanings in this letter as they do in the Agreement.

The Borrower's failure to comply with delivery of its certificate as to its compliance as referenced in subsection 4.2. of the Agreement for all applicable periods, constitutes Events of Default under the Agreement. In reliance upon the Borrower's representations and warranties contained in the Loan Documents (as defined below), and subject to the terms and conditions herein set forth, the Bank agrees to grant a waiver as follows:

In reliance upon the Borrower's representations and warranties contained in the Loan Documents (as defined below), and subject to the terms and conditions herein set forth, the Bank agrees to grant a waiver as follows:

I. Waiver. The Bank hereby grants a waiver of the Events of Default specified above.

2. Extent of Waiver. Except as expressly described above, this waiver shall not constitute (a) a modification or an alteration of any of the terms, conditions or covenants of the Agreement or any related documents, instruments and agreements (collectively as amended from time to time, the "Loan Documents"), all of which remain in full force and effect, or (b) a waiver, release or limitation upon the Bank's exercise of any of its rights and remedies thereunder, all of which are hereby expressly reserved. This waiver shall not relieve or release the Borrower or any guarantor in any way from any of its respective duties, obligations, covenants or agreements under the Agreement or the other Loan Documents or from the consequences of any Event of Default thereunder, except as expressly described above. This waiver shall not obligate the Bank, or be construed to require the Bank, to waive any other Event of Default or defaults, whether now existing or which may occur after the date of this waiver.

In addition to granting the waiver as described above, we are pleased to inform you that your Working Cash® Line of Credit has been renewed. The Expiration Date, as set forth in that certain Amended and Restated Committed Line of Credit Note dated January 10, 2011 and that certain Loan Agreement dated January 10, 2011, has been extended from January 9, 2013 to January 8, 2014, effective on January 10, 2013. All other terms and conditions of the Working Cash® Line of Credit remain in full force and effect.

It has been a pleasure working with you and I look forward to a continued successful relationship. Thank you again for your business.

Very truly yours,  
PNC BANK, NATIONAL ASSOCIATION  
\\Pamela LeRose  
Pamela LeRose  
Senior Vice President

## CERTIFICATION PURSUANT TO SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002

I, G. Patrick Lynch, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Northern Technologies International Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: January 14, 2013



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G. Patrick Lynch  
President and Chief Executive Officer  
(principal executive officer)

## CERTIFICATION PURSUANT TO SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002

I, Matthew C. Wolsfeld, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Northern Technologies International Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.



Date: January 14, 2013

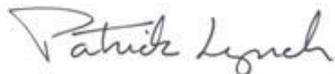
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Matthew C. Wolsfeld, CPA  
Chief Financial Officer and Corporate Secretary  
(principal financial officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Northern Technologies International Corporation (the "Company") on Form 10-Q for the period ended November 30, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, G. Patrick Lynch, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge and belief:

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



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G. Patrick Lynch  
President and Chief Executive Officer  
(principal executive officer)

Circle Pines, Minnesota  
January 14, 2013

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Northern Technologies International Corporation (the "Company") on Form 10-Q for the period ended November 30, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Matthew C. Wolsfeld, Chief Financial Officer and Corporate Secretary of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge and belief:

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



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Matthew C. Wolsfeld, CPA  
Chief Financial Officer and Corporate Secretary  
(principal financial officer and principal accounting officer)

Circle Pines, Minnesota  
January 14, 2013