



**408-436-9888**

*(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 Exchange Act during the preceding 12 months (or for such 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 smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

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

The number of shares of Common Stock outstanding as of August 12, 2012 was 22,076,976.

## **SPECIAL NOTE ON FORWARD LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2 of Part I of this report include forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as "may," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "proposed," "intended," or "continue" or the negative of these terms or other comparable terminology. You should read statements that contain these words carefully, because they discuss our expectations about our future operating results or our future financial condition or state other "forward-looking" information. There may be events in the future that we are not able to accurately predict or control. Before you invest in our securities, you should be aware that the occurrence of any of the events described in this Quarterly Report could substantially harm our business, results of operations and financial condition, and that upon the occurrence of any of these events, the trading price of our securities could decline and you could lose all or part of your investment. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, growth rates, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report to conform these statements to actual results.

**DOCUMENT CAPTURE TECHNOLOGIES, INC**

**FORM 10-Q**

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2012**

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**PART I. FINANCIAL INFORMATION****Item 1 - Financial Statements****DOCUMENT CAPTURE TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS***(in thousands)*

|   | June 30,<br>2012<br>(unaudited) | December 31,<br>2011<br>* |
|---|---------------------------------|---------------------------|
| <b>ASSETS</b>                               |                                 |                           |
| Current assets:                             |                                 |                           |
| Cash and cash equivalents                   | \$ 1,920                        | \$ 2,455                  |
| Trade receivables                           | 2,680                           | 2,207                     |
| Inventories, net                            | 1,658                           | 2,876                     |
| Prepaid expenses and other current assets   | 177                             | 226                       |
| Total current assets                        | 6,435                           | 7,764                     |
| Other non-current assets                    |                                 |                           |
| Fixed assets, net                           | 36                              | 36                        |
| Total assets                                | \$ 6,588                        | \$ 7,925                  |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b> |                                 |                           |
| Current liabilities:                        |                                 |                           |
| Line of credit                              | \$ -                            | \$ -                      |
| Trade payables to related parties, net      | 283                             | 1,014                     |
| Trade payables and other accrued expenses   | 323                             | 717                       |
| Accrued compensation and benefits           | 192                             | 444                       |
| Income tax payable                          | -                               | 23                        |
| Total current liabilities                   | 798                             | 2,198                     |
| Stock option liability                      | 39                              | 502                       |
| Deferred rent                               | 123                             | 113                       |

Commitments and contingencies (Note 11)

Stockholders' equity:

Preferred stock \$.001 par value, 2,000 authorized, 0 issued and outstanding at June 30, 2012 and December 31, 2011

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|   |           |           |
|---|-----------|-----------|
| Common stock \$.001 par value, 50,000 authorized, 22,077 and 20,578 issued and outstanding at June 30, 2012 and December 31, 2011, respectively | 22        | 21        |
| Additional paid-in capital  | 38,846    | 38,290    |
| Accumulated deficit   | (33,240 ) | (33,199 ) |
| Total stockholders' equity  | 5,628     | 5,112     |
| Total liabilities and stockholders' equity  | \$ 6,588  | \$ 7,925  |

\*Amounts derived from the audited financial statements for the year ended December 31, 2011.

**DOCUMENT CAPTURE TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)***(in thousands, except per share amounts)*

|  | Three Months Ended June<br>30, |            | Six Months Ended June<br>30, |            |
|--|--------------------------------|------------|------------------------------|------------|
|  | 2012                           | 2011       | 2012                         | 2011       |
| Net sales  | \$ 4,615                       | \$ 3,849   | \$ 9,025                     | \$ 7,431   |
| Cost of sales  | 3,125                          | 2,497      | 5,834                        | 4,874      |
| Gross profit   | 1,490                          | 1,352      | 3,191                        | 2,557      |
| Operating expenses:  |                                |            |                              |            |
| Selling, general and administrative                            | 1,409                          | 1,431      | 2,843                        | 2,848      |
| Research and development                                       | 368                            | 314        | 835                          | 631        |
| Total operating expenses                                       | 1,777                          | 1,745      | 3,678                        | 3,479      |
| Operating loss   | (287 )                         | (393 )     | (487 )                       | (922 )     |
| Non-operating income (expense), net                            | 303                            | 81         | 446                          | 282        |
| Net income (loss)  | \$ 16                          | \$ (312 )  | \$ (41 )                     | \$ (640 )  |
| Basic (loss) income per common share – basic and diluted       | \$ 0.00                        | \$ (0.02 ) | \$ (0.00 )                   | \$ (0.03 ) |
| Weighted average common shares outstanding – basic and diluted | 21,567                         | 20,578     | 20,637                       | 20,545     |

## DOCUMENT CAPTURE TECHNOLOGIES, INC.

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)***(in thousands)*

|   | Six Months Ended<br>June 30, |          |
|---|------------------------------|----------|
|   | 2012                         | 2011     |
| Operating activities:   |                              |          |
| Net loss  | \$(41 )                      | \$(640 ) |
| Adjustments to reconcile net (loss) income to net cash (used) provided by operating activities: |                              |          |
| Depreciation expense included in operating expenses   | 20                           | 25       |
| Depreciation expense included in cost of sales  | 19                           | 20       |
| Stock-based compensation cost – options   | 503                          | 646      |
| Fair value of warrants issued for services rendered   | 39                           | 41       |
| Interest expense attributable to amortization of debt issuance costs                            | 4                            | 3        |
| Allowance for slow-moving inventory   | 113                          | –        |
| Change in fair value of stock option liability  | (463 )                       | (270 )   |
| Changes in operating assets and liabilities:  |                              |          |
| Trade receivables   | (473 )                       | 594      |
| Inventories   | 1,105                        | (378 )   |
| Prepaid expenses and other  | 19                           | 103      |
| Trade payables to related parties, net  | (731 )                       | (654 )   |
| Trade payables and other current liabilities  | (646 )                       | (437 )   |
| Income taxes payable  | (23 )                        | (100 )   |
| Deferred revenue and customer deposits  | –                            | (3 )     |
| Deferred rent   | 10                           | 24       |
| Cash used by operating activities   | (545 )                       | (1,026 ) |
| Investing activities:   |                              |          |
| Capital expenditures  | (5 )                         | (24 )    |
| Cash used by investing activities   | (5 )                         | (24 )    |
| Financing activities:   |                              |          |
| Proceeds from exercise of common stock options  | 15                           | 1        |
| Cash provided by financing activities   | 15                           | 1        |
| Net decrease in cash and cash equivalents   | (535 )                       | (1,049 ) |
| Cash and cash equivalents at beginning of period  | 2,455                        | 2,322    |
| Cash and cash equivalents at end of period  | \$ 1,920                     | \$ 1,273 |
| Supplemental disclosures of cash flow information:  |                              |          |



|  |       |        |
|--|-------|--------|
| Cash paid during the period for:             |       |        |
| Income taxes                                 | \$ 45 | \$ 110 |
| Non-cash investing and financing activities: |       |        |
| Transfer of deposits to fixed assets         | \$ 26 | \$ 25  |

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***Note 1 – Background and Basis of Presentation***

***Organization***

Document Capture Technologies, Inc. (“DCT” or “the Company”) provides demand-driven solutions through the design, development, manufacture, and sale of document capture platforms. The Company’s products emphasize convenience, speed, and quality and create usable electronic content suited for database, document, content, and other systems. In doing so, these solutions are intended to reduce organizations’ operating costs, improve information accuracy and security, and speed processing time. DCT offers more than 40 variations of its imaging platforms, which are distributed globally to Tier 1 original equipment manufacturers (“OEM”), value-added resellers (“VAR”), and other systems integrators. To date, the Company has shipped nearly four million scanning products, which are marketed under private labels and used by government agencies, corporations, small offices/home offices (“SOHO”), professional practices, and consumers.

DCT’s image-scanning products can be found in a variety of applications, including but not limited, to the following:

- Document and information management;
- Identification card and driver license scanners;
- Passport security scanners;
- Bank note and check verification;
- Business card readers;
- Barcode scanning; and
- Optical mark readers used in lottery terminals.

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements of DCT have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Article 8-03 of Regulation S-X. Accordingly, they do not include all information and disclosures necessary for a presentation of the Company’s financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States (“GAAP”).

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for all periods presented have been made. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of

assets, liabilities, revenue and expenses. Actual results may differ from these estimates. The results of operations for the period ended June 30, 2012 are not necessarily indicative of the operating results that may be expected for the entire year ending December 31, 2012. The interim financial statements should be read in conjunction with the financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission ("SEC") on March 30, 2012.

The consolidated financial statements include the accounts of DCT and its one subsidiary - Syscan. All significant intercompany transactions and balances have been eliminated. DCT's functional currency is the United States (U.S.) dollar. As such, DCT does not have any translation adjustments. Monetary accounts denominated in non-U.S. currencies, such as cash or payables to vendors, have been re-measured to the U.S. dollar. Gains and losses resulting from foreign currency transactions are included in the results of operations. To date, DCT has not entered into hedging activities to offset the impact of foreign currency fluctuations.

Certain accounts have been reclassified to conform to the current period presentation. Such reclassifications did not affect DCT's total net sales, operating loss, net loss available to common stockholders, financial position or liquidity.

***Note 2 – Recent Accounting Pronouncements***

In June 2011, the Financial Accounting Standards Board (“FASB”), issued guidance regarding the presentation of comprehensive income. The new standard requires the presentation of comprehensive income (loss), the components of net income (loss) and the components of other comprehensive income (loss) either in a single continuous statement of comprehensive income (loss) or in two separate but consecutive statements. The updated guidance is effective on a retrospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. DCT had no other comprehensive income (loss) during any period presented.

In December 2011, the FASB issued new guidance requiring additional disclosures about financial instruments and derivative instruments that are either: (1) offset for balance sheet presentation purposes or (2) subject to an enforceable master netting arrangement or similar arrangement, regardless of whether they are offset for balance sheet presentation purposes. This guidance will be effective at January 1, 2013, with retrospective presentation of the new disclosures required. As this new guidance is disclosure-related only and does not amend the existing balance sheet offsetting guidance, the adoption of this guidance is not expected to have an impact on our results of operations, financial condition or liquidity.

***Note 3 – Related-Party Transactions***

*Purchases*

Historically, DCT has purchased the majority of its finished scanner imaging products from various related entities (referred to collectively as “Scanner Manufacturers”) owned by a DCT stockholder who currently owns approximately 15% of DCT’s outstanding common stock.

The Scanner Manufacturers purchase the non-critical raw materials, parts and components. DCT procures the critical components required to manufacture its proprietary scanners. Subsequently, the Scanner Manufacturers reimburse DCT for the cost of procuring these critical components.

Purchases from Scanner Manufacturers totaled \$2,414,000 and \$4,753,000 for the three and six months ended June 30, 2012, respectively, and \$2,287,000 and \$4,826,000 for the three and six months ended June 30, 2011, respectively. All purchases to and from Scanner Manufacturers were carried out in the normal course of business. As a result of the aforementioned purchases, the net due to related parties was \$283,000 and \$1,014,000 at June 30, 2012 and December 31, 2011, respectively.

*Net Sales*

During the six months ended June 30, 2011, DCT recorded sales and cost of sales of \$11,000 and \$10,000, respectively, to Scanner Manufacturers for finished scanners. DCT did not have any sales to Scanner Manufacturers during any other period presented.

All sales to Scanner Manufacturers contained similar terms and conditions as for other transactions of this nature entered into by DCT.

The aforementioned sales were all made under an exclusive license agreement between DCT and Scanner Manufacturers, which was terminated by DCT during the second quarter of 2011.

*Consulting Services*

In February 2011, DCT entered into a month-to-month product development arrangement with Darwin Hu, a current member of DCT's board of directors, whereby Mr. Hu assisted DCT with expanding the current product offering. Pursuant to the arrangement, Mr. Hu was paid \$33,000 and \$46,000 during the three and six months ended June 30, 2011, respectively. As a result of hiring a full-time chief technology officer, DCT terminated its consulting arrangement with Mr. Hu, effective October 31, 2011. Mr. Hu continues to serve as a director on DCT's board of directors.

*Legal Services Agreement*

On September 15, 2009, DCT entered into a legal services agreement ("Agreement") with Jody R. Samuels, a director of the Company. Pursuant to the Agreement, Mr. Samuels will provide certain legal services to us which will consist of assisting the Company in (i) the preparation of its periodic and other filings with the Securities and Exchange Commission ("SEC"), including proxy statements, special and annual meetings of shareholders, (ii) the negotiation of financing and corporate development transactions, (iii) preparation and review of documentation related to financing arrangements and corporate development transactions, (iv) preparing registration statements, and responding to any SEC inquiries/comment letters, (v) documenting corporate governance policies and procedures, and (vi) any other legal matters reasonably within the legal expertise of Mr. Samuels.

Pursuant to the Agreement, Mr. Samuels is paid \$4,000 per month for a total of \$12,000 and \$24,000 for the three and six months ended June 30, 2012, respectively. Mr. Samuels was paid \$12,000 and \$24,000 for the three and six months ended June 30, 2011.

The Agreement may be cancelled by either party with 30 days prior written notice.

#### *Agreement to License Office Space*

During April 2010, DCT entered into a two-year license agreement (“License”) with Beau Dietl & Associates (“BDA”) to license office space from BDA in New York City. DCT uses the office space for all meetings of the board of directors and all shareholder meetings. In connection with the License, the Company paid BDA an upfront license fee of \$50,000 as payment in full. The \$50,000 payment was capitalized and is being amortized, using the straight-line method, to selling, general and administrative expense over the term of the License.

In December 2011, DCT’s Audit Committee approved a one-year extension of the License. In connection with the extension, DCT paid BDA \$12,500 in December 2011 and \$12,500 in April 2012. Both payments were capitalized and are being amortized, using the straight-line method, to selling, general and administrative expense over the term of the License extension. The amended License extends through April 2013.

In connection with the License, DCT recorded rent expense of \$7,000 and \$13,000 for the three and six months ended June 30, 2012, respectively; and \$7,000 and \$13,000 for the three and six months ended June 30, 2011, respectively.

The License can be cancelled by either party with 90 days written notice.

#### ***Note 4 – Concentration of Credit Risk and Major Customers***

Financial instruments that subject DCT to credit risk are cash balances maintained in excess of federal depository insurance limits and trade receivables.

#### *Cash and Cash Equivalents*

DCT maintains cash balances at several banks. Cash accounts maintained in the United States are insured by the Federal Deposit Insurance Corporation ("FDIC") up to \$250,000. Non-interest bearing accounts are 100% insured. As of June 30, 2012, DCT had consolidated balances of approximately \$154,000 which were not guaranteed by the FDIC. DCT has not experienced any losses in such accounts and believes the exposure is minimal.

*Major Customers and Trade Receivables*

A relatively small number of customers account for a significant percentage of DCT's sales. Customers that exceeded 10% of total revenues and accounts receivable were as follows:

|            | Three Months Ended<br>June 30, |      | Six Months Ended<br>June 30, |      |
|------------|--------------------------------|------|------------------------------|------|
|            | 2012                           | 2011 | 2012                         | 2011 |
| Customer A | 53 %                           | 20 % | 39 %                         | 16 % |
| Customer B | 19                             | 19   | 20                           | 20   |
| Customer C | *                              | 19   | 11                           | 13   |
| Customer D | *                              | 12   | *                            | 18   |

\* Customer accounted for less than 10% for the period indicated.

Trade receivables from all significant customers at June 30, 2012 totaled \$2,230,000. As of June 30, 2012, all the Company's trade receivables were unsecured.

**Note 5 – Concentration of Supplier Risk**

Manufacturing. DCT purchases substantially all finished scanner imaging products from one source. See Note 3. If this source became unable or unwilling to provide materials in a timely manner and DCT was unable to find alternative vendors, DCT's business, operating results and financial condition would be materially adversely affected.

Components. DCT purchases some controller chips that are sole-sourced, as they are specialized devices. To date, DCT has been able to obtain adequate component supplies from existing sources. If in the future DCT became unable to obtain sufficient quantities of required materials, components or subassemblies, or if such items do not meet quality standards, delays or reductions in product shipments could occur, and this could harm DCT's business, operating results and financial condition. DCT is currently implementing alternative product designs to mitigate this existing risk.

**Note 6 – Equity Incentive Plans***General*

DCT's share-based awards are long-term retention plans that are intended to attract, retain and provide incentives for talented employees. DCT believes its share-based awards are critical to its operation and productivity. The employee share-based award plans allow DCT to grant, on a discretionary basis, incentive stock options and non-qualified stock options.

The following table sets forth, by the respective option plan, certain aspects of DCT's stock options as of June 30, 2012:

| Description                                 | Option Approval Method |                                     |           | Options Outstanding and Options Available |                            |           |
|---|------------------------|-------------------------------------|-----------|---|----------------------------|-----------|
|   | Board of Directors     | Board of Directors and Shareholders | Total     | Outstanding                               | Available For Future Grant | Total     |
| 2002 Amended and Restated Stock Option Plan | –                      | 3,200,000                           | 3,200,000 | 2,753,710                                 | 446,290                    | 3,200,000 |
| 2006 Stock Option Plan                      | –                      | 2,500,000                           | 2,500,000 | 2,299,000                                 | 201,000                    | 2,500,000 |
| 2009 Stock Option Plan                      | –                      | 1,500,000                           | 1,500,000 | 1,179,333                                 | 320,667                    | 1,500,000 |



|                             |           |            |            |            |           |            |
|-----------------------------|-----------|------------|------------|------------|-----------|------------|
| 2010 Stock Option Plan      | –         | 3,500,000  | 3,500,000  | 2,500,000  | 1,000,000 | 3,500,000  |
| Key Personnel Option Grants | 7,875,000 | –          | 7,875,000  | 4,518,465  | –         | 4,518,465  |
|                             | 7,875,000 | 10,700,000 | 18,575,000 | 13,250,508 | 1,967,957 | 15,218,465 |

### *Stock Options*

DCT issues options under four different stock option plans as well as through employment agreements with key employees, executives and consultants (approved by the board of directors on a case-by-case basis). Options generally vest over two to three years from the date of grant and expire seven to ten years from the date of grant.

### *Stock-Based Compensation*

The following table sets forth the total stock-based compensation expense included in DCT's Statements of Operations (*in thousands*):

|                                     | Three Months Ended |        | Six Months Ended |        |
|-------------------------------------|--------------------|--------|------------------|--------|
|                                     | June 30,<br>2012   | 2011   | June 30,<br>2012 | 2011   |
| Selling, general and administrative | \$ 235             | \$ 293 | \$ 468           | \$ 584 |
| Research and development            | 21                 | 31     | 35               | 62     |
| Total                               | \$ 256             | \$ 324 | \$ 503           | \$ 646 |

At June 30, 2012, DCT had approximately \$514,000 of total unrecognized compensation cost related to unvested stock options. This cost is expected to be recognized over a weighted-average period of approximately 1.2 years.

### *Stock Option Activity and Outstanding*

DCT had the following stock option activity during the six months ended June 30, 2012:

|                                  | Options      | Weighted-Average Exercise Price |
|----------------------------------|--------------|---------------------------------|
| Outstanding at December 31, 2011 | 14,524,358   | \$ 0.34                         |
| Granted                          | 275,000      | 0.35                            |
| Exercised                        | (1,498,850 ) | (0.01 )                         |
| Cancelled                        | (50,000 )    | (0.32 )                         |
| Outstanding at June 30, 2012     | 13,250,508   | \$ 0.38                         |

In April 2012, DCT's Board of Director's approved a one-year extension to 643,465 options. The total fair value of the amended options, as calculated using the Black-Scholes valuation model, was \$2,000 and was recorded as operating expense with the offsetting credit to additional paid-in capital during the three months ended June 30, 2012.

The following table summarizes all options outstanding and exercisable by price range as of June 30, 2012:

| Options Outstanding      |                    |   | Options Exercisable             |                    |                                 |
|--------------------------|--------------------|---|---------------------------------|--------------------|---------------------------------|
| Range of Exercise Prices | Number Outstanding | Weighted-Average Remaining Contractual Life (Years) | Weighted-Average Exercise Price | Number Exercisable | Weighted-Average Exercise Price |
| \$0.01                   | 643,465            | 0.8   | \$ 0.01                         | 643,465            | \$ 0.01                         |
| \$0.29-\$0.45            | 9,707,043          | 5.8   | \$ 0.32                         | 7,189,642          | \$ 0.31                         |
| \$0.60 - \$0.70          | 2,900,000          | 6.4   | \$ 0.68                         | 2,200,000          | \$ 0.68                         |
|                          | 13,250,508         |   |                                 | 10,033,107         |                                 |

The “intrinsic value” of options is the excess of the value of DCT stock over the exercise price of such options. The total intrinsic value of options outstanding (of which all are expected to vest) was approximately \$195,000 and \$1,546,000 at June 30, 2012 and December 31, 2011, respectively. The total intrinsic value for exercisable options was \$192,000 and \$1,303,000 at June 30, 2012 and December 31, 2011, respectively. The total intrinsic value was \$475,000 for options exercised during the six months ended June 30, 2012. The total intrinsic value was \$43,000 for options exercised during the six months ended June 30, 2011.

***Note 7 – Fair Value***

On August 5, 2010, DCT and NCR Corporation (“NCR”) entered into (i) Share Purchase Agreement, (ii) Investor Rights Agreement, and (iii) Voting Agreement pursuant to which NCR purchased from DCT 3,861,004 shares of the Company’s common stock for an aggregate purchase price of \$4,000,000. Additionally, DCT granted NCR a two-year option (“NCR Option”) to purchase up to an additional \$4,000,000 of Common Stock at an exercise price of \$1.036 per share, subject to adjustment. See Note 14.

Under the provisions of ASC 820, *Fair Value Measurements and Disclosures*, the NCR Option is a liability that is adjusted to its fair value at the end of each reporting period. As of June 30, 2012, DCT estimated the fair value using the Binomial option pricing model and the following assumptions: 0.04% risk-free interest rate, expected volatility of 226%, expected dividend yield of 0%, and remaining life equal to the remaining contractual life of the option.

As of December 31, 2011, DCT estimated the fair value using the Binomial option pricing model and the following assumptions: 0.12% risk-free interest rate, expected volatility of 198%, expected dividend yield of 0%, and remaining life equal to the remaining contractual life of the option.

The change in fair value each period is reported as non-operating gain or loss. Generally, this accounting treatment will result in a reported loss during any accounting period in which there is a reported increase in the value of the Company's common stock as quoted on the OTC Bulletin Board. Conversely, this accounting treatment generally will result in a reported gain during any accounting period in which there is reported decrease in the value of the Company's common stock as quoted on the OTC Bulletin Board.

DCT's stock option liability fair value is classified as a Level 3 fair value, as unobservable inputs to the valuation methodology are significant to the measurement of the fair value, as defined by ASC 820.

The following table summarizes the changes in Level 3 liabilities measured at fair value on a recurring basis (*in thousands*):

|   | As of and for the Three<br>Months Ended<br>June 30, |        | As of and for the Six<br>Months Ended<br>June 30, |        |
|---|---|--------|---|--------|
|   | 2012  | 2011   | 2012  | 2011   |
| Beginning balance - stock option liability                          | \$ 347  | \$ 618 | \$ 502  | \$ 811 |
| Unrealized loss (gain) included in net income (loss) <sup>(1)</sup> | (308 )  | (77 )  | (463 )  | (270 ) |
| Ending balance- stock option liability                              | \$ 39   | \$ 541 | \$ 39   | \$ 541 |

<sup>(1)</sup> Included as a component of non-operating income (expense).

#### ***Note 8 – Basic and Diluted Net Income (Loss) Per Common Share***

Basic earnings per common share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing net income (loss) by the weighted average number of shares of common stock and common stock equivalents outstanding during the period.

DCT had common stock equivalents (“CSE”) of 658,000 and 4,656,000 at June 30, 2012 and 2011, respectively. CSEs were taken into consideration in calculating diluted earnings per common share for the three months ended June 30, 2012, but the CSEs had no impact. CSEs were not considered in calculating DCT’s diluted earnings per common share during any other period presented as their effect would be anti-dilutive. As a result, for all periods presented, DCT’s basic and diluted earnings per share are the same.

***Note 9 – Equity***

***Common Stock***

During the six months ended June 30, 2012, DCT issued 1,498,850 shares of common stock upon the exercise of employee stock options.

During the six months ended June 30, 2011, DCT issued 98,850 shares of common stock upon the exercise of employee stock options.

***Common Stock Warrants***

In certain instances, DCT issues warrants for consulting services. DCT amortizes the fair value, as calculated on the issuance date using the Black-Scholes valuation model, of the warrants over the service period. DCT did not issue any common stock warrants during the six months ended June 30, 2012 or 2011.

In connection with such common stock warrants issued and outstanding, DCT charged selling, general and administrative expense with the offset credit to additional paid in capital for \$19,000 and \$20,000 during the three months ended June 30, 2012 and 2011, respectively; and \$39,000 and \$41,000 during the six months ended June 30, 2012 and 2011, respectively.

The following table summarizes certain aspects of DCT's outstanding warrants as of June 30, 2012:

| <b>Warrants Issued in Connection with:</b> | Number of<br>Shares<br>Outstanding<br>and Vested | <b>Exercise</b>   | <b>Issuance</b> | <b>Expiration</b> |
|--|--|-------------------|-----------------|-------------------|
|  |  | <b>Price (\$)</b> | <b>Date</b>     | <b>Date</b>       |
| Consulting agreement                       | 220,000  | 0.24-0.34         | 7/26/10         | 7/26/12           |
| Consulting agreement                       | 400,000  | 0.67              | 12/13/10        | 12/12/12          |
| Bank line of credit                        | 68,027   | 0.59              | 9/2/09          | 8/31/16           |
|  | 688,027  |                   |                 |                   |

#### ***Note 10 – Debt***

##### *Bank Line of Credit*

As of June 30, 2012, DCT had a \$3,000,000 line of credit (“LOC”) at a commercial bank. Borrowings under the LOC are limited to 80% of eligible accounts receivable less the aggregate face amount of all outstanding letters of credit, cash management services, and foreign exchange contracts. The interest rate is prime (3.25% at June 30, 2012) plus 1.0%. Interest payments are due monthly and all unpaid interest and principal is due in full on November 15, 2012.

Upon certain events of default (as defined in the LOC agreement), the default variable interest rate increases five percentage points above the interest rate applicable immediately prior to the default. Additionally, the lender has the right to declare all of the amounts due under the LOC immediately due and payable upon an event of default.

As of June 30, 2012, DCT was in compliance with all LOC debt covenants and had unused borrowing capacity of \$947,000.

*Standby Letter of Credit*

In June 2011, DCT entered into a distribution agreement that required the Company to provide a \$300,000 standby letter of credit. At June 30, 2012, DCT's LOC borrowing capacity was reduced from \$1,247,000 to \$947,000 to reflect the entire standby letter of credit. DCT's standby letter of credit expired on July 6, 2012.

*Note 11 – Commitments and Contingencies*

*Operating Leases*

DCT occupies its corporate office and warehouse space through an operating lease that extends through October 2015. As of June 30, 2012, future minimum rental commitments under non-cancellable leases were as follows (*in thousands*):

| <b>Year Ending</b> | Future<br>Minimum<br>Lease<br>Payments |
|--------------------|--|
| <b>June 30,</b>    |  |
| 2013               | \$ 228                                 |
| 2014               | 256                                    |
| 2015               | 275                                    |
| 2016               | 94                                     |
|                    | \$ 853                                 |

Additionally, under the lease agreement, DCT is responsible for common area maintenance ("CAM") charges and pro-rated taxes and insurance.

*Employment Agreements*

DCT maintains employment agreements with certain of its executive officers that provide for a base salary and annual bonus to be determined by the Board of Directors. The agreements also provide for termination payments, stock options, non-competition provisions, and other terms and conditions of employment. In addition, DCT maintains employment agreements with other key employees with similar terms and conditions. As of June 30, 2012 termination payments totaling \$1,166,000 remain in effect.

*Litigation, Claims and Assessments*

The Company experiences routine litigation in the normal course of its business and does not believe that any pending litigation will have a material adverse effect on DCT's financial condition, results of operations or cash flows.

***Note 12 –Inventories***

Inventories at the end of each period were as follows (*in thousands*):

|                           | June 30,<br>2012 | December 31,<br>2011 |
|---------------------------|------------------|----------------------|
| Raw materials             | \$ 276           | \$ 803               |
| Finished goods            | 1,528            | 2,106                |
|                           | 1,804            | 2,909                |
| Less: Inventory allowance | (146 )           | (33 )                |
|                           | \$ 1,658         | \$ 2,876             |

***Note 13 – Segment and Geographic Information***

*Segment Information*

DCT operates in one segment: the design, development and delivery of various imaging technology solutions, most notably scanners.



*Geographic Information*

During the three and six months ended June 30, 2012 and 2011, DCT recorded net sales throughout the U.S., Europe and other, and Asia as determined by the final destination of the product. The following table summarizes total net sales attributable to significant countries (*in thousands*):

|                  | Three Months Ended |          | Six Months Ended |          |
|------------------|--------------------|----------|------------------|----------|
|                  | June 30,<br>2012   | 2011     | June 30,<br>2012 | 2011     |
| U.S.             | \$ 3,805           | \$ 3,676 | \$ 7,952         | \$ 7,043 |
| Europe and other | 630                | 173      | 893              | 377      |
| Asia             | 180                | -        | 180              | 11       |
|                  | \$ 4,615           | \$ 3,849 | \$ 9,025         | \$ 7,431 |

Presented below is information regarding identifiable assets, classified by operations located in the U.S., Europe and Asia (*in thousands*):

|                  | June 30,<br>2012 | December 31,<br>2011 |
|------------------|------------------|----------------------|
| U.S.             | \$ 6,106         | \$ 7,357             |
| Europe and other | 426              | 516                  |
| Asia             | 56               | 52                   |
|                  | \$ 6,588         | \$ 7,925             |

Assets located in Europe relate to DCT's field service, sales, distribution and inventory management in the Netherlands. Assets located in Asia relate to tooling equipment required to manufacture DCT's product.

***Note 14 – Subsequent Events***

*Stock Option Liability*

On August 4, 2012, the NCR Option matured without being exercised. As such, DCT reclassified the fair value of NCR Option, on the maturity date, from liabilities to additional paid in capital.

## Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with Document Capture Technologies, Inc.'s ("DCT" or "Company") unaudited condensed consolidated financial statements and notes included herein. The results described below are not necessarily indicative of the results to be expected in any future period. Certain statements in this discussion and analysis, including statements regarding our strategy, financial performance and revenue sources, are forward-looking statements based on current expectations and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. Readers are referred to DCT's Annual Report on Form 10-K for the year ended December 31, 2011 as filed with the Securities and Exchange Commission on March 30, 2012. We undertake no duty to update any forward-looking statement to conform the statement to actual results or changes in our expectations.

Management's discussion and analysis of financial condition and results of operations ("MD&A") is provided as a supplement to the accompanying unaudited condensed consolidated financial statements and notes to help provide an understanding of our financial condition, changes in financial condition and results of operations. The MD&A section is organized as follows:

**Overview.** This section provides a general description of the Company's business, as well as recent developments that we believe are important in understanding the results of operations and anticipating future trends in those operations.

**Critical accounting policies.** This section provides an analysis of the significant estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

**Results of operations.** This section provides an analysis of our results of operations for the three and six months ended June 30, 2012 compared to the three and six months ended June 30, 2011. A brief description of certain aspects, transactions and events is provided, including related-party transactions that impact the comparability of the results being analyzed.

**Liquidity and capital resources.** This section provides an analysis of our financial condition and cash flows as of and for the six months ended June 30, 2012 as compared to the six months ended June 30, 2011.

**Contractual Obligations, Off-Balance-Sheet Arrangements, and Trends.** As of June 30, 2012, an overview of (i) contractual obligations, contingent liabilities and commitments, including an expected payment schedule, (ii) an explanation of off-balance-sheet arrangements, and (iii) known trends.

### Overview

We are in the business of designing, developing and delivering imaging technology solutions. Our technology is protected under multiple patents. We focus our research and development toward new deliverable and marketable technologies related to document digitization and utilization. We sell our products to customers throughout the world, including the United States, Canada, Europe, South America, Australia and Asia.

Our strategy includes a plan to expand our document/image-capture product line and technology while leveraging our assets in other areas of the imaging industry. Our anticipated expansion centers around supporting our existing customers' needs while also cultivating new relationships; developing hardware, software, and cloud-based innovations; and establishing new IP to protect and enrich our competitive position.

### *Critical Accounting Policies*

Our MD&A is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, trade receivables and allowance for doubtful accounts, inventories, and income taxes. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used or changes in the accounting estimate that are reasonably likely to occur could materially change the financial statements.

Our disclosures of critical accounting policies in our Annual Report on Form 10-K for the year ended December 31, 2011 have not materially changed since that report was filed.

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## Results of Operations

The following table summarizes certain aspects of our results of operations for the three and six months ended June 30, 2012 compared to the three and six months ended June 30, 2011 (*in thousands*):

|   | Three Months Ended June 30, |         |       |      | Six Months Ended June 30, |         |         |      |
|---|-----------------------------|---------|-------|------|---------------------------|---------|---------|------|
|   | 2012                        | 2011    | \$    | %    | 2012                      | 2011    | \$      | %    |
| Net sales                                   | \$4,615                     | \$3,849 | \$766 | 20 % | \$9,025                   | \$7,431 | \$1,594 | 21 % |
| Cost of sales                               | 3,125                       | 2,497   | 628   | 25   | 5,834                     | 4,874   | 960     | 20   |
| As a percentage of sales                    | 67.7 %                      | 64.9 %  |       |      | 64.6 %                    | 65.6 %  |         |      |
| Selling, general and administrative expense | 1,409                       | 1,431   | (22 ) | (2 ) | 2,843                     | 2,848   | (5 )    | (- ) |
| Research and development expense            | 368                         | 314     | 54    | 17   | 835                       | 631     | 204     | 32   |
| Non-operating income (expense)              | 303                         | 81      | 222   | 274  | 446                       | 282     | 164     | 58   |
| Net income (loss)                           | 16                          | (312 )  | 328   | NM   | (41 )                     | (640 )  | 599     | NM   |

NM = Not Meaningful

## Net Sales

Net sales grew for all periods presented resulting from a 24% and 14% increased number of unit sales for the three and six months ended June 30, 2012 compared to the three and six months ended June 30, 2011, respectively. The majority of the increase was attributable to organic growth experienced by our existing, recurring customers. Our weighted average selling price decreased for the three months ended June 30, 2012 and increased for the six months ended June 30, 2012 as compared to the same periods in 2011 in each case primarily as a result of the mix of products sold and volume-related discounts.

International sales as a percentage of sales were 18% and 4% for the three months ended June 30, 2012 and 2011, respectively; and 12% and 5% for the six months ended June 30, 2012 and 2011, respectively. The increase in the relative percentage of international sales resulted from the globalization and expansion of our product into Europe and Asia.

Although we continue to concentrate on expanding our significant customer base, our revenue remains dependent on a small number of significant customers. Total sales to significant customers (customers who represent more than 10%

of our net sales) as a percentage of total sales were 72% and 70% during the three months ended June 30, 2012 and 2011, respectively; and 70% and 67% during the six months ended June 30, 2012 and 2011, respectively. See Note 4 included in Part I, "Item 1- Financial Statements." The identities of our largest customers and their respective contributions to our net sales have varied in the past and will likely continue to vary from period to period.

From time to time, our key customers place large orders causing our quarterly sales to fluctuate significantly. Additionally, the timing of when we receive product to sell has a significant impact to our sales. We expect both of these trends and resulting fluctuations to continue.

*Cost of Sales, Including Gross Profit*

Cost of sales includes all direct costs related to the purchase of scanners and imaging modules manufactured in China, and to services related to the delivery of those items. To a lesser extent, cost of sales also includes engineering services, software royalties and depreciation of manufacturing equipment. For scanners where the final assembly and test is completed in the U.S., additional labor costs are included.

Cost of sales as a percentage of sales increased during the three months ended June 30, 2012 compared to the three months ended June 30, 2011 and decreased during the six months ended June 30, 2012 compared to the six months ended June 30, 2011 as a result of product mix, currency fluctuations, and volume-related discounts.

Our cost of sales as a percentage of sales has been affected in the past, and may continue to be affected in the future, by various factors, including, but not limited to, the following:

- Our product mix and volume of product sales (including sales to high volume customers).
- Changes to customer requirements for third-party software integrated into our products.
- Manufacturing efficiencies and inefficiencies, including cost reduction strategies.
- Currency fluctuations between the Chinese Yuan and the U.S. Dollar.
- Product expansion.

The proportion of sales generated from scanners assembled in the U.S. versus the proportion of scanners assembled at our subcontract manufacturer in China.

- Provisions for slow-moving inventories.
- Our ability to advance to the next technology faster than our competitors.

We expect our cost of sales as a percentage of net sales to fluctuate in the future as we experience changes in our product mix, work toward implementing further product cost reduction strategies, and expand our product offerings.

#### *Selling, General and Administrative Expense*

Selling, general and administrative expenses consist primarily of personnel-related expenses, including stock-based compensation costs, facilities-related expenses and outside professional services such as legal and accounting. To a lesser extent, market development and promotional funds for our retail distribution channels, tradeshows, website



support, warehousing and logistics are also included.

Although total S,G&A expenses decreased by only one percent during the three months ended June 30, 2012 as compared to the three months ended June 30, 2011 and remained flat during the six months ended June 30, 2012 compared to the six months ended June 30, 2011, certain expenses within S,G&A increased and others decreased:

Increased headcount and compensation-related increases of approximately \$87,000 and \$210,000 during the three and six months ended June 30, 2012 compared to the same period in 2011. Increased headcount was necessary to attract and retain talent required for business expansion.

Increased computer-related expenses of approximately \$33,000 and \$66,000 during the three and six months ended June 30, 2012 compared to the same period in 2011 resulting from our IT and infrastructure upgrades.

Decreased stock-based compensation expense (a non-cash charge) as a result of fully amortized options during the latter part of 2011. Stock-based compensation cost was \$235,000 and \$293,000 for the three months ended June 30, 2012 and 2011, respectively. Stock-based compensation cost was \$468,000 and \$584,000 for the six months ended June 30, 2012 and 2011, respectively. See "Note 6 - Equity Incentive Plans" in Part I, Item 1 of this Form 10-Q.

We anticipate that future selling, general and administrative expenses will fluctuate as we concentrate on growing our business by expanding our customer base, product offering, revenue base, and our global presence.

### *Research and Development Expense*

Research and development expense consists primarily of salaries and related costs, including stock-based compensation costs of employees engaged in product research, design and development activities, compliance testing, documentation, prototypes and expenses associated with transitioning the product to production. The increased research and development expense during the three and six months ended June 30, 2012 compared to the three and six months ended June 30, 2011 was primarily attributable to: (i) increased personnel expenses for internal engineers and our newly-hired chief technology officer (“CTO”); and (ii) expenses associated with accelerating the development of new products. In connection with the hiring of our CTO, we renewed our focus and commitment toward product innovation and overall IP strategy. Our renewed focus includes expanding our existing technology, developing new technology, and licensing third-party technology to complement our technology and allow for quicker time to market.

We anticipate that research and development expense will continue to increase as a result of our aforementioned renewed commitment toward product innovation and overall IP strategy.

### *Non-Operating Income (Expense)*

The most significant component of our non-operating income (expense) was a non-cash gain related to the decreased fair value of our stock option liability. The non-cash gain totaled \$308,000 and \$77,000 for the three months ended June 30, 2012 and 2011, respectively; and \$463,000 and \$270,000 for the six months ended June 30, 2012 and 2011, respectively. See “Note 7 – Fair Value” in Part I, Item 1 of this Form 10-Q. Generally, DCT will report a non-cash gain during any accounting period in which there is a reported decrease in the value of the Company’s common stock as quoted on the OTC Bulletin Board. Other less impactful components include non-cash interest expense related to amortization of warrants and realized loss on foreign currency transactions resulting from the currency fluctuation between the Euro and the U.S. dollar.

### **Liquidity and Capital Resources**

At June 30, 2012, principal sources of liquidity included cash and cash equivalents of \$1,920,000 and an available borrowing capacity of \$947,000 on our bank line of credit. On July 6, 2012, our available borrowing capacity increased to \$1,247,000 due to the expiration of a standby letter of credit, which is no longer required by one of our suppliers. We had no significant cash outlays, except as part of our normal operations, during the six months ended June 30, 2012 or June 30, 2011.

The following table summarizes certain aspects of DCT's liquidity (*in thousands*):

|                                       | As of or for the Six<br>Months Ended June 30, |          |
|---------------------------------------|---|----------|
|                                       | 2012  | 2011     |
| Cash and cash equivalents             | \$ 1,920                                      | \$ 1,273 |
| Line of credit balance                | —   | —        |
| Working capital                       | 5,637   | 4,615    |
| Cash used by operating activities     | (545 )  | (1,026 ) |
| Cash used by investing activities     | (5 )  | (24 )    |
| Cash provided by financing activities | 15  | 1        |

Operating activities: During the six months ended June 30, 2012, our operating activities used \$545,000 of cash. This was a result of our \$41,000 net loss, \$235,000 of net non-cash expenses which includes an allowance for slow-moving inventory of \$113,000, and \$739,000 net cash used by changes in operating assets and liabilities. During the six months ended June 30, 2011, our operating activities used \$1,026,000 of cash. This was a result of our \$640,000 net loss, \$465,000 of net non-cash expenses, and \$851,000 net cash used by changes in operating assets and liabilities.

Net non-cash expenses include: depreciation expense, stock-based compensation cost for options, fair value of warrants issued for services rendered, non-cash interest expense, allowance for slow-moving inventory, and change in fair value of stock option liability.

The most significant changes in operating assets and liabilities during the six months ended June 30, 2012 included:

- *Trade receivables* increased as a result of our significantly increased sales during June 2012.
- *Inventories* decreased due to the shipment of products during the first quarter of 2012, which was originally scheduled for shipment in December 2011.
- *Trade payables to related parties, net* decreased as a result of a temporary reduction to payment terms from 45-days to 30-days to support the manufacturing transition to next generation scanner components.
- *Trade payables and other current liabilities* decreased primarily due to the payment of third-party software licenses, bonuses and one-time relocation obligations, which were accrued at December 31, 2011.

The most significant changes in operating assets and liabilities during the six months ended June 30, 2011 included:

- *Trade receivables* decreased due to the timing of shipments to, and the collection of cash from, customers. Specifically, we experienced significant shipments at the end of the fourth quarter of 2010 that were collected during the first quarter of 2011.
- *Inventories* increased primarily due to timing of shipments from the factory and to customers.
- *Trade payables to related parties, net* decreased and *Due from related parties, net* increased due to timing of payments, and shipment of (i) inventory purchased from related parties and (ii) critical components used to manufacture inventory, purchased by DCT, and subsequently reimbursed by related parties. At June 30, 2011, the amount due from related parties for critical components exceeded the amount owed to related parties for inventory purchases. Reimbursements by related parties for critical components were temporarily delayed while the factory, which manufactures DCT's scanners, was relocated from Shenzhen, China to Wuhan, China. The new building was successfully completed and the factory was fully operational on June 1, 2011.
- *Trade payables and other current liabilities* decreased due to the payments of severance and executive relocation obligations during the first quarter of 2011, which were accrued at December 31, 2010.

The remaining changes in operating assets and liabilities during both the six months ended June 30, 2012 and 2011 were indicative of the normal operational fluctuations related to the timing of product shipments, trade receivable collections, inventory management, and timing of vendor payments.

We expect future cash provided (used) by operating activities to fluctuate, primarily as a result of fluctuations in operating results, timing of product shipments, trade receivables collections, inventory management including the expansion of our product offerings, and timing of vendor payments.

Investing activities: Investing activities for both the six months ended June 30, 2012 and 2011 included capital purchases to support normal business operations.

Financing activities: During both the six months ended June 30, 2012 and 2011, financing activities consisted of proceeds received from the exercise of employee stock options.

*Cash and Working Capital Requirements*

Our strengthened financial position has enabled us to actively pursue growth. Further developing our product line will strengthen our industry-leading position in the marketplace. However, in the near term it may constrain working capital.

In addition, we anticipate entering into strategic relationships that will enhance and expand our current product offerings, which may increase our revenues. We believe the anticipated expansion will complement our existing business. Such expansion may require us to incur additional expenses in the near term and may take some time to fully develop. Additionally, there is no guarantee that our expansion will be successful.

Management believes that current cash and other sources of liquidity are sufficient to fund normal operations and anticipated growth through the next 12 months.

### ***Contractual Obligations***

The following table summarizes our contractual obligations at June 30, 2012, and the effect such obligations are expected to have on our liquidity and cash flows in future periods (*in thousands*):

|                                    | Total | Less Than<br>One Year | One – Three<br>Years | Four – Five<br>Years |   |
|------------------------------------|-------|-----------------------|----------------------|----------------------|---|
| Operating lease obligations        | \$853 | \$ 228                | \$ 625               | \$                   | – |
| Line of credit <sup>(1)</sup>      | –     | –                     | –                    | –                    | – |
| Total contractual cash obligations | \$853 | \$ 228                | \$ 625               | \$                   | – |

<sup>(1)</sup> As of June 30, 2012, DCT had a \$3,000,000 line of credit (“LOC”) at a commercial bank. Borrowings under the LOC are limited to 80% of eligible accounts receivable less the aggregate face amount of all outstanding letters of credit, cash management services, and foreign exchange contracts. The interest rate is prime (3.25% at June 30, 2012) plus 1.0%. Interest payments are due monthly and all unpaid interest and principal is due in full on November 15, 2012.

Upon certain events of default (as defined in the LOC agreement), the default variable interest rate increases five percentage points above the interest rate applicable immediately prior to the default. Additionally, the lender has the right to declare all of the amounts due under the LOC immediately due and payable upon an event of default.

As of June 30, 2012, DCT was in compliance with all LOC debt covenants and had unused borrowing capacity of \$947,000.

In June 2011, DCT entered into a distribution agreement that required the Company to provide a \$300,000 standby letter of credit. At June 30, 2012, DCT’s LOC borrowing capacity was reduced from \$1,247,000 to \$947,000 to reflect the entire standby letter of credit. DCT’s standby letter of credit expired on July 6, 2012.

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

At June 30, 2012, we did not have any relationship with unconsolidated entities or financial partnerships, which other companies have established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Therefore, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

*Trends*

To the best of our knowledge, except for the commitments described in “Note 11 - Commitments and Contingencies” in Part I, Item 1 of this Form 10-Q, there are no other known trends or demands, commitments, events or uncertainties that existed at June 30, 2012, which are likely to have a material effect on our future liquidity.

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#### **Item 4 – Controls and Procedures**

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

Based on management's evaluation (with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO")), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act")), are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

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

There were no changes to our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

##### *Inherent Limitations on Effectiveness of Controls*

Our management, including the CEO and CFO, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.



## **PART II. OTHER INFORMATION**

### **Item 1 - Legal Proceedings**

We are subject to various legal proceedings from time to time in the ordinary course of business, none of which is required to be disclosed under this Item 1.

### **Item 1A – Risk Factors**

There have been no changes to the risk factors included in our Annual Report on Form 10-K for the year ended December 31, 2011 as filed with the Securities and Exchange Commission on March 30, 2012.

### **Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds**

In April 2012, we issued an aggregate of 1,398,850 shares of our common stock upon the exercise of an aggregate of 1,398,850 options to purchase shares of our common stock. The exercise price of the options was \$0.01 per share. The shares of common stock were issued pursuant to the exemption provided by Section 4(2) of the Securities Act of 1933, as amended.

### **Item 3 - Defaults Upon Senior Securities**

None.

### **Item 4 – Removed and Reserved**

### **Item 5 - Other Information**

None.

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**Item 6 - Exhibits**

| Exhibit Number | Description of Exhibit  | Method of Filing |
|----------------|---|------------------|
| 31.1           | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act – David P. Clark    | Filed herewith   |
| 31.2           | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act – M. Carolyn Ellis  | Filed herewith   |
| 32.1           | Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act – David P. Clark   | Filed herewith   |
| 32.2           | Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act – M. Carolyn Ellis | Filed herewith   |

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## **SIGNATURES**

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

Document Capture Technologies, Inc.

Date: August 14, 2012

/s/ David P. Clark

David P. Clark, Chief Executive Officer

Date: August 14, 2012

/s/ M. Carolyn Ellis

M. Carolyn Ellis

Chief Financial Officer