

DOCUMENT CAPTURE TECHNOLOGIES, INC.
Form 10-Q
August 11, 2010

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2010

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: 000-25839

DOCUMENT CAPTURE TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

80-0133251
(I.R.S. Employer
Identification Number)

1798 Technology Drive
Suite 178
San Jose, California 95110
(Address of principal executive offices, Zip code)

408-436-9888 ext. 207
(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 11, 2010 was 23,267,274.

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, 2010

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PART I. FINANCIAL INFORMATION

Item 1 - Financial Statements

DOCUMENT CAPTURE TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

| | June 30, 2010 (unaudited) | December 31, 2009 * |
|--|---------------------------------|---------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 306 | \$ 328 |
| Trade receivables | 2,016 | 1,497 |
| Inventories, net | 1,331 | 1,674 |
| Prepaid expenses and other current assets | 88 | 132 |
| Total current assets | 3,741 | 3,631 |
| Restricted cash | 5 | 5 |
| Other assets | 21 | - |
| Fixed assets, net | 160 | 176 |
| Total assets | \$ 3,927 | \$ 3,812 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Line of credit | \$ - | \$ 202 |
| Trade payables to related parties | 147 | 341 |
| Trade payables and other accrued expenses | 405 | 440 |
| Accrued compensation and benefits | 117 | 124 |
| Deferred revenue and customer deposits | 50 | 111 |
| Total current liabilities | 719 | 1,218 |
| Commitments and contingencies (Note 10) | | |
| Stockholders' equity: | | |
| Preferred stock \$.001 par value, 2,000 authorized, 0 issued and Outstanding June 30, 2010 and December 31, 2009 | | |
| Common stock \$.001par value, 50,000 authorized, 19,406 shares issued and outstanding at June 30, 2010 and December 31, 2009 | 19 | 19 |
| Additional paid-in capital | 36,188 | 35,697 |
| Accumulated deficit | (32,999) | (33,122) |
| Total stockholders' equity | 3,208 | 2,594 |
| Total liabilities and stockholders' equity | \$ 3,927 | \$ 3,812 |

*Amounts derived from the audited financial statements for the year ended December 31, 2009.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|----------|---------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Net sales | \$ 3,302 | \$ 3,002 | \$ 6,730 | \$ 5,017 |
| Cost of sales | 2,022 | 1,824 | 4,125 | 3,061 |
| Gross profit | 1,280 | 1,178 | 2,605 | 1,956 |
| Operating expenses: | | | | |
| Selling, general and administrative | 986 | 911 | 1,952 | 2,100 |
| Research and development | 279 | 202 | 544 | 433 |
| Total operating expenses | 1,265 | 1,113 | 2,496 | 2,533 |
| Operating income (loss) | 15 | 65 | 109 | (577) |
| Total other income (expense) | 52 | 1 | 16 | 1 |
| Net income (loss) before income taxes | 67 | 66 | 125 | (576) |
| Provision for income taxes | - | - | 2 | - |
| Net income (loss) | 67 | 66 | 123 | (576) |
| Accretion of preferred stock redemption value | - | (13) | - | (25) |
| Net income (loss) available to common stockholders | \$ 67 | \$ 53 | \$ 123 | \$ (601) |
| Basic income (loss) per common share | \$ 0.00 | \$ 0.00 | \$ 0.01 | \$ (0.03) |
| Diluted income (loss) per common share | \$ 0.00 | \$ 0.00 | \$ 0.01 | \$ (0.03) |
| Weighted average common shares outstanding | 19,406 | 18,469 | 19,406 | 18,466 |
| Weighted average common shares outstanding, assuming dilution | 24,285 | 22,354 | 24,285 | 18,466 |

DOCUMENT CAPTURE TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(in thousands)

| | Six Months Ended June 30, | |
|---|------------------------------|----------|
| | 2010 | 2009 |
| Operating activities: | | |
| Net income (loss) | \$ 123 | \$ (576) |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: | | |
| Depreciation expense included in operating expenses | 30 | 27 |
| Depreciation expense included in cost of sales | 31 | - |
| Stock-based compensation cost – options | 419 | 298 |
| Fair value of common stock and warrants issued for services rendered | 72 | 111 |
| Other non-cash income/expenses, net | 32 | (9) |
| Changes in operating assets and liabilities: | | |
| Trade receivables | (519) | (17) |
| Inventories | 343 | 360 |
| Prepaid expenses and other | 20 | (31) |
| Trade payables to related parties | (194) | (277) |
| Trade payables and other current liabilities | (42) | 134 |
| Income taxes payable | - | (75) |
| Deferred revenue and customer deposits | (61) | (49) |
| Cash provided (used) by operating activities | 254 | (104) |
| Investing activities: | | |
| Capital expenditures | (45) | (55) |
| Cash used by investing activities | (45) | (55) |
| Financing activities: | | |
| Net (payments) advances on bank line of credit | (225) | 1,216 |
| Deferred financing costs | (6) | - |
| Cash (used) provided by financing activities | (231) | 1,216 |
| Net (decrease) increase in cash and cash equivalents | (22) | 1,057 |
| Cash and cash equivalents at beginning of period | 328 | 405 |
| Cash and cash equivalents at end of period | \$ 306 | \$ 1,462 |

Note 1 – Background and Basis of Presentation

Organization

Document Capture Technologies, Inc. ("DCT" or "Company") develops, designs and delivers various imaging technology solutions to all types and sizes of enterprises including governmental agencies, large corporations, small corporations, small office-home offices ("SOHO"), professional practices as well as consumers (referred to herein collectively as "Enterprises"). DCT is a market-leader in providing USB-powered scanning solutions to a wide variety of industries and market applications. DCT's patented and proprietary page-imaging devices facilitate the way information is stored, shared and managed for both business and personal use.

Syscan, Inc., DCT's wholly-owned subsidiary, was incorporated in California in 1995 to develop and manufacture a new generation of contact image sensors ("CIS") that are complementary metal-oxide-silicon ("CMOS") imaging sensor devices. During the late 1990s, DCT established many technical milestones and was granted numerous patents for its linear imaging technology. DCT's patented CIS and mobile imaging scanner technology provides high quality images at extremely low power consumption levels allowing delivery of compact scanners in a form ideally suited for laptop or desktop computer users who need a small, lightweight device to scan or fax documents.

DCT's business model was developed around intellectual property ("IP") driven products sold primarily to original equipment manufacturers ("OEM"), private label brands and value added resellers ("VAR") and 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, 2010 are not necessarily indicative of the operating results that may be expected for the entire year ending December 31, 2010. 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, 2009, filed with the Securities and Exchange Commission ("SEC") on March 31, 2010.

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.

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

Note 2 – Recent Accounting Pronouncements

In October 2009, the FASB issued new standards for revenue recognition with multiple deliverables. These new standards impact the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. Additionally, these new standards modify the manner in which the transaction consideration is allocated across the separately identified deliverables by no longer permitting the residual method of allocating arrangement consideration. These new standards are effective for fiscal years beginning on or after June 15, 2010; however, early adoption is permitted. DCT does not expect these new standards to significantly impact its consolidated financial statements.

In October 2009, the FASB issued new standards for the accounting for certain revenue arrangements that include software elements. These new standards amend the scope of pre-existing software revenue guidance by removing from the guidance non-software components of tangible products and certain software components of tangible products. These new standards are required to be adopted in the first quarter of 2011; however, early adoption is permitted. DCT does not expect these new standards to significantly impact its consolidated financial statements.

Note 3 – Related-Party Transactions

Purchases

Historically, the Company has purchased the majority of its finished scanner imaging products from Shenzhen Syscan Technology (“SST”), a wholly-owned subsidiary of Syscan Technology Holdings Limited (“STH”). SST currently holds approximately 16% of DCT's outstanding common stock.

Purchases from SST totaled \$1,632,000 and \$3,486,000 for the three and six months ended June 30, 2010, respectively, and \$1,270,000 and \$2,443,000 for the three and six months ended June 30, 2009, respectively. All purchases from SST were carried out in the normal course of business. As a result of these purchases, DCT was liable to SST for \$147,000 and \$341,000 at June 30, 2010 and December 31, 2009, respectively.

Net Sales

During the three and six months ended June 30, 2010, DCT recorded net sales totaling \$24,000 and \$70,000, respectively, for finished scanners sold to SST. The related cost of sales was \$21,000 and \$60,000, respectively. DCT had no sales or cost of sales to SST during the three or six months ended June 30, 2009. All sales to SST contained similar terms and conditions as for other transactions of this nature entered into by DCT.

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, 2010, respectively. The Agreement may be cancelled by either party with 30 days prior written notice.

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Agreement to License Office Space

On April 26, 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. The purpose of the License is for DCT to have a physical presence in New York City. 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 connection with the License, DCT recorded rent expense of \$4,000 for both the three and six months ended June 30, 2010.

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

Stock Option Grants and Amended Consulting Agreement

On April 29, 2010, the Company’s board of directors approved an amendment to the business advisory and consulting agreement between the Company and each of Richard “Bo” Dietl and Daniel DelGiorno (the “Consultants”) dated July 28, 2008, whereby in addition to the services already being provided pursuant to the agreement, the Consultants will provide investor relations services in exchange for options to purchase up to 1,500,000 shares of the Company’s common stock at a price of \$0.30 per share. The options vest over a two year period with 50% of such options vesting at the end of the first and second years of the agreement; however, in the event of a change of control in the Company’s securities or assets pursuant to introductions specifically made by Consultants to the Company, all of the options shall immediately vest 100% in conjunction with such event. A change of control shall be defined as a change of ownership of 50% or more of the Company’s securities, or voting control thereof, or a transfer of more than 50% of the Company’s tangible and/or intangible assets. See Note 6 for discussion of the associated stock-based compensation cost.

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. DCT invests its excess cash balances in an overnight investment account, which is not FDIC insured. As of June 30, 2010, DCT had consolidated balances of approximately \$53,000, 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 | | Six Months Ended | |
|------------|--------------------|------|------------------|------|
| | June 30, | | June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Customer A | 17% | 12% | 11% | 11% |
| Customer B | 16 | 17 | 18 | 23 |
| Customer C | 15 | 19 | 15 | 19 |

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| | | | | |
|------------|----|----|----|----|
| Customer D | 11 | 16 | 19 | 10 |
| Customer E | 10 | * | * | * |
| Customer F | * | 13 | * | 10 |

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

Trade receivables from all significant customers at June 30, 2010 totaled \$1,631,000. As of June 30, 2010, all the Company's trade receivables were unsecured.

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Note 5 – Concentration of Supplier Risk

DCT purchases substantially all finished scanner imaging products from one vendor that is also a wholly-owned subsidiary of the parent company of its former majority stockholder. See Note 3. If this vendor 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.

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.

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 June 30, | | Six Months Ended June 30, | |
|-------------------------------------|--------------------------------|--------|------------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Selling, general and administrative | \$ 218 | \$ 105 | \$ 356 | \$ 252 |
| Research and development | 31 | 13 | 63 | 46 |
| Total | \$ 249 | \$ 118 | \$ 419 | \$ 298 |

At June 30, 2010, DCT had approximately \$1,869,000 of total unrecognized compensation cost related to unvested stock options. This cost is expected to be recognized over a weighted-average period of approximately 2.1 years.

Stock Option Activity and Outstanding

DCT had the following stock option activity during the six months ended June 30, 2010:

| | Options | Weighted- Average Exercise Price |
|----------------------------------|------------|---|
| Outstanding at December 31, 2009 | 11,355,498 | \$ 0.32 |
| Granted | 2,700,000 | 0.30 |
| Exercised | - | - |
| Cancelled | (311,000) | (0.45) |

| | | | |
|------------------------------|------------|----|------|
| Outstanding at June 30, 2010 | 13,744,498 | \$ | 0.31 |
|------------------------------|------------|----|------|

The following table summarizes all options outstanding and exercisable by price range as of June 30, 2010:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | | |
|-----------------------------|-----------------------|--|---|-----------------------|---|--|
| | Number Outstanding | Weighted- Average Remaining Contractual Life (Years) | Weighted- Average Exercise Price | Number Exercisable | Weighted- Average Exercise Price | |
| \$0.01 | 2,241,165 | 1.82 | \$ 0.01 | 2,241,165 | \$ 0.01 | |
| \$0.29 - \$0.35 | 9,603,333 | 7.47 | \$ 0.31 | 1,534,583 | \$ 0.30 | |
| \$0.60 - \$0.70 | 1,900,000 | 6.55 | \$ 0.69 | 1,900,000 | \$ 0.69 | |
| | 13,744,498 | | | 5,675,748 | | |

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 \$2,022,000 and \$788,000 at June 30, 2010 and December 31, 2009, respectively. The total intrinsic value for exercisable options was \$1,101,000 and \$722,000 at June 30, 2010 and December 31, 2009, respectively. No options were exercised during the six months ended June 30, 2010.

Note 7 – Basic and Diluted Net Income (Loss) Per Common Share

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

Common stock equivalents were not considered in calculating diluted net loss per common share for the six months ended June 30, 2009 as their effect would be anti-dilutive. Common stock equivalents were taken into consideration in calculating diluted net income per common share for the three and six months ended June 30, 2010 and the three months ended June 30, 2009, but the impact did not change net income per share. As a result, for all periods presented, DCT’s basic and diluted net income (loss) per share is the same.

The computation of DCT’s basic and diluted earnings per share for the three and six months ended June 30, 2010 and the three months ended June 30, 2009 is as follows (in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, |
|---|--------------------------------|---------|---------------------------------|
| | 2010 | 2009 | 2010 |
| Net income available to common shareholders (A) | \$ 67 | \$ 53 | \$ 123 |
| Impact of convertible preferred stock | - | 13 | - |
| Net income available to common shareholders used in diluted share calculation (B) | \$ 67 | \$ 66 | \$ 123 |
| Weighted average common shares outstanding (C) | 19,406 | 18,469 | 19,406 |
| Dilutive effect of convertible preferred stock | - | 441 | - |
| Dilutive effect of warrants | 64 | | 64 |
| Dilutive effect of employee equity incentive plans | 4,815 | 3,444 | 4,815 |
| Weighted average common shares outstanding, assuming dilution (D) | 24,285 | 22,354 | 24,285 |
| Basic earnings per common share (A)/(C) | \$ 0.00 | \$ 0.00 | \$ 0.01 |
| Diluted earnings per common share (B)/(D) | \$ 0.00 | \$ 0.00 | \$ 0.01 |

For the three and six months ended June 30, 2010, DCT excluded 2,693,000 (5,445,000 for the three months ended June 30, 2009) of stock options and warrants from the calculation of diluted earnings per common share as the exercise prices of these stock options and warrants were greater than or equal to the market value of the common shares. Such options and warrants could be included in the calculation in the future if the market value of DCT’s common shares increases and is greater than the exercise price of these options and warrants.

Note 8 – Equity

Common Stock

DCT had no common stock activity during the six months ended June 30, 2010.

DCT's Board of Directors approved the issuance of 25,000 restricted common shares to a consultant for investor relations services rendered during the six months ended June 30, 2009. The common shares have piggyback registration rights to the next registration statement filed by DCT. DCT amortized the estimated fair value of the common shares ratably over the service period. Accordingly, \$11,000 was charged to selling, general and administrative expense and credited to additional paid-in capital during the six months ended June 30, 2009.

Preferred Stock

During the three and six months ended June 30, 2009, DCT reported \$13,000 and \$25,000 of accretion of preferred stock redemption value associated with its series B convertible redeemable preferred stock ("Series B Stock"), which matured August 7, 2009. DCT had no other preferred stock activity during any period presented.

Common Stock Warrants

DCT had the following common stock warrant activity during the six months ended June 30, 2010:

| | Warrants |
|----------------------------------|-------------|
| Outstanding at December 31, 2009 | 2,002,027 |
| Expired | (1,209,000) |
| Issued | 220,000 |
| Outstanding at June 30, 2010 | 1,013,027 |

In certain instances, DCT issues warrants for consulting services. DCT amortizes the fair value of such warrants over the service period. 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 \$32,000 and \$72,000 during the three and six months ended June 30, 2010, respectively, and \$100,000 during the six months ended June 30, 2009.

DCT estimated the fair value of the warrants issued under the Black-Scholes valuation model using the following weighted average assumptions during the six months ended June 30, 2010: contractual term of two years, 0.6% risk-free interest rate, expected volatility of 285% and expected dividend yield of 0%. Assumptions during the six months ended June 30, 2009 were: contractual term of three years, 1.8% risk-free interest rate, expected volatility of 266% and expected dividend yield of 0%.

Note 9 – Bank Line of Credit

As of June 30, 2010, DCT had a \$2,000,000 line of credit ("LOC") at a commercial bank. Borrowings under the LOC are limited to (i) 80% of eligible accounts receivable less the aggregate face amount of all outstanding letters of credit, cash management services, and foreign exchange contracts, and (ii) 40% of eligible inventory (all as defined in the LOC agreement). The interest rate is prime (3.25% at June 30, 2010) plus 2.75% for advances drawn against receivables, with a minimum interest rate of 6%; and prime plus 3.75% for advances drawn against inventory, with a minimum interest rate of 7%. Interest payments are due monthly and all unpaid interest and principal is due in full on September 2, 2010.

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, 2010, DCT was in compliance with all LOC debt covenants and had unused borrowing capacity of \$1,928,000.

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During September 2009, in connection with the LOC origination, DCT paid the lender a loan origination fee and legal fees which totaled approximately \$20,000, and issued a warrant to purchase 68,027 shares of the Company's Common Stock at \$0.588 per share. During March 2010, in connection with increasing the LOC borrowing base, DCT paid the lender a loan modification fee of \$6,000. The loan origination, modification, and legal fees are recorded as deferred financing costs included in other current assets and are being amortized over the life of the loan to interest expense. The \$35,000 fair value of the warrants was determined using the Black-Scholes valuation model with the following assumptions: remaining contractual term of 7 years, 2.9% risk-free interest rate, expected volatility of 406% and expected dividend yield of 0%. The fair value of the warrants was initially recorded as debt discount, with an offset to additional paid in capital, and has been amortized over the life of the loan to interest expense.

Interest Expense Related to Amortization of Warrant Fair Values and Loan Origination Fee

The Company recorded interest expense of \$17,000 and \$32,000 during the three and six months ended June 30, 2010 in connection with the LOC warrants and amortization of the LOC origination, modification and legal fees.

Note 10 – Commitments and Contingencies

Operating Leases

As of June 30, 2010, our current office and warehouse facility leases were both month-to-month with no future rental commitment. We anticipated finalizing a new lease, in a new co-located facility, by September 30, 2010. The new lease will (i) combine our corporate office and warehouse spaces, and (ii) increase square footage to expand domestic production capabilities.

Employment Agreements

DCT maintains employment agreements with its executive officers which extend through 2010. The agreements 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, 2010, termination payments totaling \$1,055,000 remain in effect.

OEM and Development Agreement

During the second quarter of 2009, the Company entered into an OEM agreement ("OEM Agreement") with a customer to sell scanners. The OEM Agreement was subsequently amended to include product development ("Development Agreement"). To date, DCT has only sold product under the OEM Agreement. The customer has the right to cancel the contract at any time without cause upon giving DCT two weeks' notice (see Note 13). Upon cancellation, each party shall retain its rights in any intellectual property rights owned or licensed to it prior to commencement of development. All intellectual property ("IP") developed by DCT under the Development Agreement will be owned exclusively by DCT, except for specific parts and mechanism designs provided by the customer.

At June 30, 2010, DCT had \$36,000 of deferred revenue associated with the Development Agreement.

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 11 – Settlement of Legal Proceedings

During November 2007, a legal complaint was filed against DCT seeking declaratory judgment that one of DCT's patents is invalid and not infringed by the claimant ("Claimant"). The complaint ("Case A") was filed in the U.S. District Court, Northern District of California.

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During March 2007, DCT filed a legal complaint against Claimant seeking damages and declaratory relief for breach of a license agreement between DCT and Claimant. The complaint (“Case B”) was filed in the U.S. District Court, Northern District of California.

During May 2010, DCT and Claimant entered into an agreement to (i) dismiss Case A without prejudice, (ii) dismiss Case B with prejudice to both parties, and (iii) settle other legal issues and disputes arising from Case A and Case B (“Settlement”). In connection with the Settlement, DCT received monies from Claimant, which was recorded as non-operating income.

Note 12 – 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, 2010 and 2009, 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, | | June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| U.S. | \$ 3,088 | \$ 2,836 | \$ 6,193 | \$ 4,547 |
| Europe and other | 190 | 156 | 467 | 460 |
| Asia | 24 | 10 | 70 | 10 |
| | \$ 3,302 | \$ 3,002 | \$ 6,730 | \$ 5,017 |

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

| | December 31, | |
|--------|---------------|----------|
| | June 30, 2010 | 2009 |
| U.S. | \$ 3,695 | \$ 3,574 |
| Europe | 161 | 128 |
| Asia | 71 | 110 |
| | \$ 3,927 | \$ 3,812 |

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 13 – Subsequent Events

Cancellation of Development Agreement

On July 23, 2010, the aforementioned Development Agreement (see Note 10) was cancelled by DCT’s customer. DCT will continue to sell product under the OEM Agreement. During the third quarter of 2010, DCT anticipates

recognizing \$36,000 of revenue originally deferred until product under the Development Agreement was sold. Management does not believe the cancellation of the Development Agreement will have a material impact on DCT's results of operations.

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NCR Purchase of Common Stock

On August 5, 2010 (“Purchase Date”), DCT and NCR Corporation (“NCR”) entered into (i) Share Purchase Agreement (“Purchase Agreement”), (ii) Investor Rights Agreement (“IR Agreement”), and (iii) Voting Agreement (“Voting Agreement”) pursuant to which NCR purchased from DCT 3,861,004 shares (the “Shares”) of the Company’s common stock, par value \$.001 per share, (“Common Stock”) for an aggregate purchase price of \$4,000,000 (the “Investment”). Additionally, DCT granted NCR a two-year option (“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, as more fully described below. Neither the Shares nor the Option have been registered with the Securities and Exchange Commission. However, NCR received demand registration rights, subject to certain limitations, and unlimited piggy-back registration rights with respect to the Shares and any shares of Common Stock issued upon exercise of the Option. The registration rights terminate when all of the Shares and any shares of Common Stock issued upon exercise of the Option may be sold pursuant to Rule 144 without restriction or limitation, or, if earlier, on the fifth anniversary of the Purchase Date.

The Investment has anti-dilution protection for eighteen months following the date of the IR Agreement. Under the anti-dilution provisions, unless waived by NCR, issuances or deemed issuances of Common Stock with an effective price that is less than \$1.036 (as adjusted), would result in the issuance of additional shares of Common Stock, determined on a full ratchet basis, to NCR.

The Option is exercisable at any time or from time to time for two years from the Purchase Date. The exercise price of the Option is subject to adjustment for stock splits or combinations; dividends or distributions payable in shares of Common Stock; reclassifications, exchanges or substitutions; and reorganizations, mergers, consolidations or sales of assets. The exercise price of the Option is also subject to adjustment, on a full ratchet basis, for issuances or deemed issuances of Common Stock with an effective price that is less than the Option exercise price then in effect.

The Voting Agreement is between DCT, NCR and certain investors of DCT. Under the Voting Agreement, NCR was granted the right to appoint a board observer to attend meetings of DCT’s Board of Directors in a nonvoting observer capacity. NCR was also granted the right, at its discretion, to designate a member of DCT’s Board of Directors. DCT stockholders, who are party to the Voting Agreement, agreed, in the event of any such designation, to vote their shares of Company stock to elect NCR’s designee. Such stockholders also agreed that, at NCR’s request, they would not sell their shares of DCT’s stock for up to 180 days following the effective date of a final prospectus covering the resale of DCT’s stock by NCR.

Concurrent with the execution of the Purchase Agreement, DCT and NCR also amended their existing Strategic Supplier Master Procurement Agreement (the “Reseller Agreement”). The Reseller Agreement, dated July 17, 2009, covers the manufacture and sale by DCT to NCR, and the purchase and resale by NCR, of specified scanning products. The original Reseller Agreement had a three-year term, which automatically renewed unless either party gave at least 180 days’ prior written notice. The amendment extends the current term to August 6, 2014, and provides, subject to certain exceptions, that DCT will not sell, directly or indirectly, any products to any entity who engages in the business of (i) operating or supplying remote deposit capture products, services or functionality or (ii) operating or supplying product that facilitate the scanning, transmitting, storage of electronic documents on a bank’s secure server.

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, 2009 as filed with the Securities and Exchange Commission on March 31, 2010. 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, 2010 compared to the three and six months ended June 30, 2009. 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, 2010 as compared to the six months ended June 30, 2009.
- **Contractual Obligations, Off-Balance-Sheet Arrangements, and Trends.** As of June 30, 2010, an overview of (i) contractual obligations and 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, Africa, South America, Australia and Asia.

Strategy

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. We are actively shipping five groups of image-capture products, and will be expanding our product offerings to meet the increased market demand for: (1) faster, easier-to-use products; and (2) enhanced security, including identity and financial transaction protection.

We are currently negotiating a new lease that will (i) combine our corporate office and warehouse spaces, and (ii) increase square footage to expand domestic production capabilities. By combining our corporate office and warehouse spaces, we will gain significant operational efficiencies. We are expanding our domestic production capabilities to capitalize on certain market-specific opportunities, particularly with federal, state and local government agencies that require products to be manufactured in the U.S. under the Trade Agreements Act (“TAA”).

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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 on-going 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, 2009 have not materially changed since that report was filed.

Results of Operations

The following table summarizes certain aspects of our results of operations for the three and six months ended June 30, 2010 compared to the three and six months ended June 30, 2009 (in thousands):

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|-----------------------------|----------|--------|-----|---------------------------|----------|----------|-----|
| | 2010 | 2009 | \$ | % | 2010 | 2009 | \$ | % |
| Net sales | \$ 3,302 | \$ 3,002 | \$ 300 | 10% | \$ 6,730 | \$ 5,017 | \$ 1,713 | 34% |
| Cost of sales | 2,022 | 1,824 | 198 | 11 | 4,125 | 3,061 | 1,064 | 35 |
| As a percentage of sales | 61% | 61% | | | 61% | 61% | | |
| Selling, general and administrative expense | 986 | 911 | 75 | 8 | 1,952 | 2,100 | (148) | (7) |
| Research and development expense | 279 | 202 | 77 | 38 | 544 | 433 | 111 | 26 |
| Non-operating income (expense) | 52 | 1 | NM | NM | 16 | 1 | NM | NM |

NM = Not Meaningful

Net Sales

During the first quarter of 2009, we experienced the bottom of the severe slowdown of the U.S. economy and related slowdown of information technology (“IT”) capital spending that began in 2008. Revenues rebounded during the remainder of 2009 and have continued strong during the first two quarters of 2010. As such, revenues for both the three and the six months ended June 30, 2010 were higher compared to the three and six months ended June 30, 2009. Specifically, the increase in revenues is a result of increased number of scanners sold; sales of scanners increased 3% and 40% for the three and six months ended June 30, 2010 compared to the three and six months ended June 30, 2009. Our average selling price fluctuated during both the three and six months ended June 30, 2010 as a result of the mix of products sold and certain volume-related price discounts.

Our international sales continue to be a strategic component of our business. International revenues as a percentage of revenues remain fairly consistent: 6% for both the three months ended June 30, 2010 and 2009; and 8% and 9% for the six months ended June 30, 2010 and 2009, respectively. The majority of our international revenues are in Europe. Because our products can be easily configured to support different languages, and we provide ongoing support for Romanized, Cyrillic and Sinographic character software, we are able to actively pursue revenue opportunities in many different international markets.

We have successfully expanded our significant customer base. And as a result, total sales to significant customers (customers who represent more than 10% of our net sales) decreased to 69% during the three months ended June 30, 2010 from 77% during the three months ended 2009; and decreased to 63% during the six months ended June 30, 2010 from 73% during the six months ended June 30, 2009. See “Note 4: Concentration of Credit Risk and Major Customers” in Part I, Item 1 of this Form 10-Q. 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 net revenue to fluctuate significantly. We expect this trend and resulting fluctuations to continue. Although the number of scanners shipped during any quarter has fluctuated, our selling prices remained fairly stable; we expect both trends to continue for the foreseeable future.

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. Although overall cost of sales as a percentage of sales remained steady for all periods presented, it is dependent on, and may vary with, the following factors:

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- Mix of products sold;
- Changes to the negotiated prices of our finished product and key components;
- Customer requirements for third-party software integrated into our products; and
- Changes to the proportion of scanners assembled in the U.S. versus the proportion of scanners assembled in China.

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.

The increase in selling, general and administrative expense during the three months ended June 30, 2010 as compared to the three months ended June 30, 2009 was primarily attributable to the following:

- Increased stock-based compensation costs (a non-cash charge). Stock-based compensation cost was \$218,000 and \$105,000 for the three months ended June 30, 2010 and June 30, 2009, respectively. See “Note 6 - Employee Equity Incentive Plans” in Part I, Item 1 of this Form 10-Q.
- Increased amortization of the fair value (a non-cash charge) of equity instruments issued for consulting services. Amortization increased to \$32,000 during the three months ended June 30, 2010 from \$0 during the three months ended June 30, 2009. See “Note 8 - Equity” in Part I, Item 1 of this Form 10-Q.

The above increases were somewhat offset by our decreased investor relations expenses associated with DCT’s initiatives to reduce cash operating expenses.

The decrease in selling, general and administrative expense during the six months ended June 30, 2010 as compared to the six months ended June 30, 2009 was primarily attributable to the following:

- Decreased investor relations efforts associated with DCT’s initiatives to reduce cash operating expenses;
- Decreased accounting fees associated with retaining the same independent accounting firm from year to year; and
- Decreased legal fees.

We anticipate that selling, general and administrative expenses will continue to fluctuate as our business continues to grow. However, we continue to work to offset these expenses by reducing overhead expenses and streamlining operations.

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 was primarily attributable to increased personnel expenses, as our headcount during the three and six months ended June 30, 2010 was double the headcount during the three and six months ended June 30, 2009.

We anticipate that research and development expense will continue to increase over the long term as a result of the growth of our existing products, new product opportunities and expansion into new markets and technologies. We remain committed to significant research and development efforts to extend our technology leadership in the imaging technology markets.

Non-Operating Income (Expense)

The most significant components of our non-operating income (expense) during the three and six months ended June 30, 2010 were (i) Cash payment received in June 2010 as settlement for two pending lawsuits and other legal issues, (ii) interest expense on our line of credit, and (iii) realized loss on foreign currency resulting from the devaluation of the Euro against the US dollar.

Non-operating income (expense) during both the three and six months ended June 30, 2009 was immaterial to our results of operations.

Liquidity and Capital Resources

At June 30, 2010, principal sources of liquidity included cash and cash equivalents of \$306,000 and an available borrowing capacity of \$1,928,000 on our bank line of credit. We had no significant cash outlays, except as part of our normal operations, during the six months ended June 30, 2010 or June 30, 2009.

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

| | As of or for the Six Months Ended June 30, | |
|--|---|----------|
| | 2010 | 2009 |
| Cash and cash equivalents | \$ 306 | \$ 1,462 |
| Line of credit | - | 1,216 |
| Working capital | 3,022 | 1,616 |
| Cash provided (used) by operating activities | 254 | (104) |
| Cash used by investing activities | (45) | (55) |
| Cash (used) provided by financing activities | (231) | 1,216 |

Operating activities: During the six months ended June 30, 2010, our operating activities provided \$254,000 of cash. This was a result of our \$123,000 net income, \$584,000 of net non-cash expenses, and \$453,000 net cash used by changes in operating assets and liabilities. During the six months ended June 30, 2009, our operating activities used \$104,000 of cash. This was a result of our \$576,000 net loss, \$427,000 of net non-cash expenses, and \$45,000 net cash provided by changes in operating assets and liabilities.

Non-cash items included in net loss are depreciation expense, stock-based compensation cost of options, fair value of warrants issued for services rendered, and amortization of debt discount. The most significant change in operating assets and liabilities during the six months ended June 30, 2010 was the \$519,000 increased accounts receivable resulting from a significant cash collections effort during December 2009. This effort resulted in the early collection of approximately \$487,000 of receivables prior December 31, 2009. Had we not undertaken this the early collection effort, the change in accounts receivable would have only been a \$32,000 use of cash. The remaining changes in operating assets and liabilities during both the six months ended June 30, 2010 and 2009 were indicative of the normal operational fluctuations related to the timing of product shipments, trade receivable collections, inventory management, and timing of vendor payments.

Investing activities: Investing activities for both the six months ended June 30, 2010 and 2009 included capital purchases to support normal business operations.

Financing activities: During the six months ended June 30, 2010, financing activities consisted of (i) negotiating an increase to our existing line of credit borrowing base, and (ii) \$225,000 pay off of our line of credit. During the six months ended June 30, 2009, financing activities consisted of a \$1,216,000 draw against our bank line of credit to meet short-term obligations incurred during the normal course of business.

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Cash and Working Capital Requirements

We actively control operating expenses to align with current and projected net sales. If we continue to successfully manage our projected net sales and control our operating expenses, of which there can be no assurance, management believes that current cash and other sources of liquidity are sufficient to fund normal operations through the next 12 months.

Our current line of credit matures on September 2, 2010. Our current lender has already communicated the desire to extend DCT's current credit facility through September 2011. Although management believes DCT will be able to obtain an additional line of credit upon maturity of the existing line of credit, there is no guarantee that DCT will be able to secure a line of credit on terms that are acceptable to DCT.

Contractual Obligations

As of June 30, 2010, our office and warehouse leases were both month-to-month with no future rental commitment. We anticipate finalizing a new lease by September 30, 2010. The new lease will (i) combine our corporate office and warehouse spaces, and (ii) increase square footage to expand domestic production capabilities. The expected contractual obligations are summarized (in thousands):

| | Total | Less Than One Year | One – Three Years | More than Three Years |
|--------------------------------------|----------|-----------------------|----------------------|-----------------------------|
| Bank line of credit (1) | \$ - | \$ - | \$ - | \$ - |
| Expected operating lease obligations | 1,657 | 229 | 1,030 | 398 |
| Total contractual cash obligations | \$ 1,657 | \$ 229 | \$ 1,030 | \$ 398 |

(1) As of June 30, 2010, we had \$0 balance on our \$2,000,000 bank line of credit ("LOC"). Borrowings under the LOC are limited to (i) 80% of eligible accounts receivable less the aggregate face amount of all outstanding letters of credit, cash management services, and foreign exchange contracts, and (ii) 40% of eligible inventory (all as defined in the LOC agreement). The interest rate is prime (3.25% at June 30, 2010) plus 2.75% for advances drawn against receivables, with a minimum interest rate of 6%; and prime plus 3.75% for advances drawn against inventory, with a minimum interest rate of 7%. Interest payments are due monthly and all unpaid interest and principal is due in full on September 2, 2010.

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, 2010, we were in compliance with all LOC debt covenants and had unused borrowing capacity of \$1,928,000.

Off-Balance Sheet Arrangements

At June 30, 2010, 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 10 - 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, 2010, 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, (the 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 Securities and Exchange Commission 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.

Changes in Internal Controls over Financial Reporting

As of March 31, 2010, our CEO and CFO concluded that our disclosure controls and procedures were not effective as of March 31, 2010 for the sole reason that DCT's Board of Directors did not include an independent financial expert. Effective June 8, 2010, DCT added an independent financial expert to its Board of Directors, which resulted in effective, comprehensive, entity-level internal controls. With the addition of the newly appointed independent financial expert, our CEO and CFO were able to conclude that internal controls were effective as of June 30, 2010.

There were no changes, other than as discussed above, in our internal controls over financial reporting that occurred during the quarterly 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

During November 2007, a legal complaint was filed against DCT seeking declaratory judgment that one of DCT's patents is invalid and not infringed by the claimant ("Claimant"). The complaint ("Case A") was filed in the U.S. District Court, Northern District of California.

During March 2007, DCT filed a legal complaint against Claimant seeking damages and declaratory relief for breach of a license agreement between DCT and Claimant. The complaint ("Case B") was filed in the U.S. District Court, Northern District of California.

During May 2010, DCT and Claimant entered into an agreement to (i) dismiss Case A without prejudice, (ii) dismiss Case B with prejudice to both parties, and (iii) settle other legal issues and disputes arising from Case A and Case B ("Settlement"). In connection with the Settlement, DCT received monies from Claimant, which was recorded as non-operating income.

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, 2009 as filed with the Securities and Exchange Commission on March 31, 2010.

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

None.

Item 3 - Defaults Upon Senior Securities

None.

Item 5 - Other Information

None.

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 | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act – David P. Clark | Filed herewith |
| 32.2 | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act – M. Carolyn Ellis | Filed herewith |

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 11, 2010
/s/ David P. Clark
David P. Clark, Chief
Executive Officer

Date: August 11, 2010
/s/ M. Carolyn Ellis
M. Carolyn Ellis
Chief Financial Officer