

DOCUMENT CAPTURE TECHNOLOGIES, INC.
Form 10-Q
November 14, 2012

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
X ACT OF 1934**

For the Quarterly Period Ended September 30, 2012

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

For the transition period from to

Commission File Number: 000-25839

DOCUMENT CAPTURE TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware 80-0133251
(State or other jurisdiction of (I.R.S.Employer
incorporation or organization) Identification Number)

4255 Burton Drive

Santa Clara, California 95054

(Address of principal executive offices, Zip code)

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 November 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 September 30, 2012

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

	September 30, 2012 (unaudited)	December 31, 2011 *
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,232	\$ 2,455
Trade receivables	2,631	2,207
Inventories, net	2,083	2,876
Note receivable	300	-
Prepaid expenses and other current assets	181	226
Total current assets	7,427	7,764
Other non-current assets		
Fixed assets, net	36	36
Total assets	\$ 7,560	\$ 7,925
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit	\$ -	\$ -
Trade payables to related parties, net	1,297	1,014
Trade payables and other accrued expenses	417	717
Accrued compensation and benefits	173	444
Income tax payable	-	23
Total current liabilities	1,887	2,198
Stock option liability		
Deferred rent	-	502
	128	113

Commitments and contingencies (Note 12)

Stockholders' equity:

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Preferred stock \$.001 par value, 2,000 authorized, 0 issued and outstanding at September 30, 2012 and December 31, 2011		
Common stock \$.001 par value, 50,000 authorized, 22,077 and 20,578 issued and outstanding at September 30, 2012 and December 31, 2011, respectively	22	21
Additional paid-in capital	39,090	38,290
Accumulated deficit	(33,567)	(33,199)
Total stockholders' equity	5,545	5,112
Total liabilities and stockholders' equity	\$ 7,560	\$ 7,925

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

See accompanying notes.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net sales	\$ 4,105	\$ 5,253	\$ 13,130	\$ 12,684
Cost of sales	2,694	3,214	8,528	8,088
Gross profit	1,411	2,039	4,602	4,596
Operating expenses:				
Selling, general and administrative	1,320	1,454	4,163	4,302
Research and development	465	300	1,300	931
Total operating expenses	1,785	1,754	5,463	5,233
Operating (loss) income	(374)	285	(861)	(637)
Non-operating income (expense), net	47	335	493	617
Net (loss) income	\$(327)	\$ 620	\$(368)	\$(20)
Basic (loss) income per common share	\$(0.01)	\$ 0.03	\$(0.02)	\$(0.00)
Diluted (loss) income per common share	\$(0.01)	\$ 0.03	\$(0.02)	\$(0.00)
Weighted average common shares outstanding – basic	22,077	20,578	20,651	20,556
Weighted average common shares outstanding – assuming dilution	22,077	22,641	20,651	20,556

See accompanying notes.

DOCUMENT CAPTURE TECHNOLOGIES, INC.

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

	Nine Months Ended September 30,	
	2012	2011
Operating activities:		
Net loss	\$ (368)	\$ (20)
Adjustments to reconcile net (loss) income to net cash (used) provided by operating activities:		
Depreciation expense included in operating expenses	31	36
Depreciation expense included in cost of sales	33	30
Stock-based compensation cost – options	727	971
Fair value of warrants issued for services rendered	59	60
Interest expense attributable to amortization of debt issuance costs	6	4
Allowance for slow-moving inventory	113	–
Change in fair value of stock option liability	(502)	(618)
Changes in operating assets and liabilities:		
Trade receivables	(424)	(915)
Inventories	680	(490)
Prepaid expenses and other	13	47
Trade payables to related parties, net	283	(132)
Trade payables and other current liabilities	(571)	(266)
Income taxes payable	(23)	(100)
Deferred revenue and customer deposits	–	(25)
Deferred rent	15	36
Cash provided (used) by operating activities	72	(1,382)
Investing activities:		
Capital expenditures	(10)	(28)
Investment in note receivable	(300)	–
Cash used by investing activities	(310)	(28)
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	(223)	(1,409)
Cash and cash equivalents at beginning of period	2,455	2,322
Cash and cash equivalents at end of period	\$ 2,232	\$ 913

Supplemental disclosures of cash flow information:

Cash paid during the period for:

Income taxes	\$ 45	\$ 110
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Non-cash investing and financing activities:

Transfer of deposits to fixed assets	\$ 26	\$ 32
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See accompanying notes.

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DOCUMENT CAPTURE TECHNOLOGIES, INC. AND SUBSIDIARY

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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, quality, and security 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 September 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.

DOCUMENT CAPTURE TECHNOLOGIES, INC. AND SUBSIDIARY

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 \$2,939,000 and \$7,692,000 for the three and nine months ended September 30, 2012, respectively, and \$3,008,000 and \$7,834,000 for the three and nine months ended September 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 \$1,297,000 and \$1,014,000 at September 30, 2012 and December 31, 2011, respectively.

Net Sales

Sales and cost of sales to Scanner Manufacturers totaled \$18,000 and \$16,000, respectively for both the three and nine months ended September 30, 2012. During the nine months ended September 30, 2011, DCT recorded sales and cost of sales of \$11,000 and \$10,000, respectively, to Scanner Manufacturers for finished scanners. All sales to Scanner Manufacturers contained similar terms and conditions as for other transactions of this nature entered into by DCT.

Consulting Services Provided by Members of the Board of Directors

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 \$29,000 and \$75,000 during the three and nine months ended September 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.

During August and September 2011, DCT paid \$11,000 to CSO on Call, LLC ("CSO"), a company owned by Roseann Larson, who is a current member of DCT's board of directors. The payment was for consulting services provided by Ms. Larson.

Legal Services Agreement

During September 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 DCT 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.

DOCUMENT CAPTURE TECHNOLOGIES, INC. AND SUBSIDIARY

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Pursuant to the Agreement, Mr. Samuels is paid \$4,000 per month for a total of \$12,000 and \$36,000 for the three and nine months ended September 30, 2012, respectively. Mr. Samuels was paid \$12,000 and \$36,000 for the three and nine months ended September 30, 2011.

The Agreement may be canceled 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. Mr. Dietl is DCT’s Chairman of the board of directors. 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 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 \$6,000 and \$19,000 for the three and nine months ended September 30, 2012, respectively; and \$6,000 and \$19,000 for the three and nine months ended September 30, 2011, respectively.

The License can be canceled 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 September 30, 2012, DCT had consolidated balances of approximately \$203,000 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		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Customer A	31 %	20 %	37 %	18 %
Customer B	17	15	13	14
Customer C	12	12	*	16
Customer D	*	11	16	16
Customer E	*	23	*	10

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

Trade receivables from all significant customers at September 30, 2012 totaled \$1,792,000. As of September 30, 2012, all the Company's trade receivables were unsecured.

DOCUMENT CAPTURE TECHNOLOGIES, INC. AND SUBSIDIARY

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 – Note Receivable

During September 2012, DCT's board of directors authorized a \$300,000 investment in Advanced Cyber Systems Corp. ("ACSC") in the form of a convertible note receivable ("ACSC Note"). The ACSC Note pays five percent interest per year. Principal and interest are both due on September 17, 2013 ("Maturity Date"). At any time prior to the Maturity Date, DCT is