

DOCUMENT CAPTURE TECHNOLOGIES, INC.
Form 10-Q
November 14, 2011

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 September 30, 2011

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)

4255 Burton Drive
San Jose, 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, 2011 was 20,578,126.

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, 2011

INDEX

| | Page |
|---------------------------------------|---|
| PART I – FINANCIAL INFORMATION | |
| Item 1 | Financial Statements 4 |
| Item 2 | Management’s Discussion and Analysis of Financial Condition and Results of Operations 5 |
| Item 4 | Controls and Procedures 6 |
| PART II – OTHER INFORMATION | |
| Item 1 | Legal Proceedings 26 |
| Item 1A | Risk Factors 26 |
| Item 2 | Unregistered Sales of Equity Securities and Use of Proceeds 26 |
| Item 3 | Defaults Upon Senior Securities 26 |
| Item 4 | Removed and Reserved 26 |
| Item 5 | Other Information 26 |
| Item 6 | Exhibits 27 |
| | Signatures 28 |

PART I. FINANCIAL INFORMATION

Item 1 - Financial Statements

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

| | September 30, 2011 (unaudited) | December 31, 2010 * |
|---|--------------------------------------|---------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 913 | \$ 2,322 |
| Trade receivables | 3,454 | 2,539 |
| Inventories, net | 2,220 | 1,730 |
| Prepaid expenses and other current assets | 184 | 259 |
| Total current assets | 6,771 | 6,850 |
| Other non-current assets | | |
| Fixed assets, net | 36 | 44 |
| Total assets | \$ 6,946 | \$ 7,039 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Line of credit | \$ - | \$ - |
| Trade payables to related parties, net | 522 | 654 |
| Trade payables and other accrued expenses | 713 | 546 |
| Accrued compensation and benefits | 279 | 712 |
| Deferred revenue and customer deposits | 4 | 29 |
| Income tax payable | - | 100 |
| Total current liabilities | 1,518 | 2,041 |
| Stock option liability | 193 | 811 |
| Long-term deferred rent | 106 | 70 |
| Commitments and contingencies (Note 11) | | |
| Stockholders' equity: | | |
| Preferred stock \$.001 par value, 2,000 authorized, 0 issued and outstanding at September 30, 2011 and December 31, 2010 | - | - |
| Common stock \$.001 par value, 50,000 authorized, 20,578 and 20,479 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively | 21 | 20 |
| Additional paid-in capital | 37,971 | 36,940 |
| Accumulated deficit | (32,863) | (32,843) |
| Total stockholders' equity | 5,129 | 4,117 |
| Total liabilities and stockholders' equity | \$ 6,946 | \$ 7,039 |

*Amounts derived from the audited financial statements for the year ended December 31, 2010.

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, | |
|---|-------------------------------------|-----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Net sales | \$5,253 | \$3,539 | \$12,684 | \$10,269 |
| Cost of sales | 3,214 | 2,138 | 8,088 | 6,263 |
| Gross profit | 2,039 | 1,401 | 4,596 | 4,006 |
| Operating expenses: | | | | |
| Selling, general and administrative | 1,454 | 1,332 | 4,302 | 3,284 |
| Research and development | 300 | 263 | 931 | 807 |
| Total operating expenses | 1,754 | 1,595 | 5,233 | 4,091 |
| Operating income (loss) | 285 | (194) | (637) | (85) |
| Non-operating income (expense), net | 335 | (234) | 617 | (218) |
| Net income (loss) before income taxes | 620 | (428) | (20) | (303) |
| Income taxes | - | - | - | 2 |
| Net income (loss) | \$620 | \$(428) | \$(20) | \$(305) |
| Basic income (loss) per common share | \$0.03 | \$(0.02) | \$(0.00) | \$(0.02) |
| Diluted income (loss) per common share | \$0.03 | \$(0.02) | \$(0.00) | \$(0.02) |
| Weighted average common shares outstanding | 20,578 | 21,826 | 20,556 | 20,213 |
| Weighted average common shares outstanding, assuming dilution | 22,641 | 21,826 | 20,556 | 20,213 |

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

| | Nine Months Ended September 30, | |
|--|------------------------------------|----------|
| | 2011 | 2010 |
| Operating activities: | | |
| Net loss | \$(20) | \$(305) |
| Adjustments to reconcile net loss to net cash provided (used) by operating activities: | | |
| Depreciation expense included in operating expenses | 36 | 40 |
| Depreciation expense included in cost of sales | 30 | 40 |
| Stock-based compensation cost – options | 971 | 663 |
| Fair value of warrants issued for services rendered | 60 | 72 |
| Change in fair value of stock option liability | (618) | 232 |
| Other non-cash income/expenses, net | 4 | 45 |
| Changes in operating assets and liabilities: | | |
| Trade receivables | (915) | (765) |
| Inventories | (490) | 298 |
| Prepaid expenses and other | 47 | (62) |
| Trade payables to related parties | (132) | 453 |
| Trade payables and other current liabilities | (266) | (119) |
| Income taxes payable | (100) | – |
| Deferred revenue and customer deposits | (25) | (85) |
| Long-term deferred rent | 36 | 18 |
| Cash (used) provided by operating activities | (1,382) | 525 |
| Investing activities: | | |
| Capital expenditures | (28) | (52) |
| Cash used by investing activities | (28) | (52) |
| Financing activities: | | |
| Net payments on bank line of credit | – | (225) |
| Proceeds from issuance of common stock, net of issuance costs | – | 3,973 |
| Payments for repurchase of common stock | – | (604) |
| Deferred financing costs | – | (8) |
| Proceeds from exercise of common stock options | 1 | – |
| Cash provided by financing activities | 1 | 3,136 |
| Net (decrease) increase in cash and cash equivalents | (1,409) | 3,609 |
| Cash and cash equivalents at beginning of period | 2,322 | 328 |
| Cash and cash equivalents at end of period | \$913 | \$3,937 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for: | | |

| | | |
|--|-------|------|
| Interest | \$- | \$16 |
| Income taxes | \$110 | \$2 |
| Non-cash investing and financing activities: | | |
| Transfer of deposits to fixed assets | \$32 | \$- |

- 6 -

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 lightweight and compact scanners in a form ideally suited for laptop or desktop computer users who need a small, lightweight device to scan 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"). Our 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.

During the second quarter of 2011, DCT expanded its strategy by entering an agreement with a Taiwan-based multi-national designer, developer and manufacturer of proprietary scanner technology. This agreement gives DCT exclusive rights to distribute four products in North America; two products are high-speed portable and desktop scanning devices fitted with an automatic document feeder ("ADF"), and two products are compact flatbed scanners. These products increase and augment DCT's already industry-leading image capture offerings across a broad range of price points and functionality.

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, 2011 are not necessarily indicative of the operating results that may be expected for the entire year ending December 31, 2011. 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, 2010, filed with the Securities and Exchange Commission ("SEC") on March 16, 2011.

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 income (loss), net income (loss), financial position or liquidity.

Note 2 – Recent Accounting Pronouncements

Multiple Element Arrangements Excluding Software

DCT occasionally enters into revenue arrangements that contain multiple deliverables. Judgment is required to properly identify the accounting units of the multiple deliverable transactions and to determine the manner in which revenue should be allocated among the accounting units. Moreover, judgment is used in interpreting the commercial terms and determining when all criteria of revenue recognition have been met for each deliverable in order for revenue recognition to occur in the appropriate accounting period. While changes in the allocation of the arrangement consideration between the units of accounting will not affect the amount of total revenue recognized for a particular sales arrangement, any material changes in these allocations could impact the timing of revenue recognition, which could affect DCT's results of operations.

The Financial Accounting Standards Board ("FASB") issued amended revenue recognition guidance for arrangements with multiple deliverables by allowing management's best estimate of selling price for individual elements of an arrangement when vendor-specific evidence or third party evidence is unavailable.

Comprehensive Income

The FASB issued guidance regarding the presentation of comprehensive income. The new standard requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new standard also requires presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented. 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. The adoption of this guidance will not have a material impact on DCT's financial statements.

Fair Value

The FASB issued additional guidance on fair value measurements that clarifies the application of existing guidance and disclosure requirements, changes certain fair value measurement principles and requires additional disclosures about fair value measurements. The updated guidance is effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance will not have a material impact on DCT's financial statements.

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 \$3,008,000 and \$7,834,000 for the three and nine months ended September 30, 2011, respectively, and \$1,989,000 and \$5,475,000 for the three and nine months ended September 30, 2010, 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 \$522,000 and \$645,000 at September 30, 2011 and December 31, 2010, respectively.

- 8 -

Net Sales

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. DCT had no sales to Scanner Manufacturers during the three months ended September 30, 2011.

During the three and nine months ended September 30, 2010, DCT recorded net sales totaling \$111,000 and \$181,000, respectively, for finished scanners sold to SST. The related cost of sales was \$93,000 and \$153,000, respectively.

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

The above 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 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 is assisting 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. See Note 14.

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.

Consulting Agreement

During the three months ended September 30, 2010, the Company entered an agreement with a consulting company to assist DCT expand its sales. When the agreement was entered into, the owner of the consulting company held approximately one percent of DCT's outstanding common stock. Upon execution of the agreement, DCT paid \$400,000, which was recorded as selling, general and administrative expense during the three months ended September 30, 2010, as services were fully rendered at the time of payment.

Reimbursed Expenses incurred by Related-Party Consultants

During the three months ended September 30, 2010, DCT reimbursed expenses incurred by related-party consultants totaling approximately \$4,400.

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 was paid \$4,000 per month for a total of \$12,000 during both the three months ended September 30, 2011 and 2010; and \$36,000 for both the nine months ended September 30, 2011 and 2010.

- 9 -

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

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 founder of BDA, Richard “Bo” Dietl, currently owns approximately 23% of the Company’s outstanding common stock. 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 \$6,000 and \$19,000 for the three and nine months ended September 30, 2011, respectively; and \$6,000 and \$10,000 for the three and nine months ended September 30, 2010, respectively.

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

On September 27, 2011, the Company’s board of directors appointed Mr. Dietl to serve as its Chairman of the board of directors.

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, 2011, DCT had consolidated balances of approximately \$366,000 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 were as follows:

| | Three Months Ended | | Nine Months Ended | |
|------------|--------------------|------|-------------------|------|
| | September 30, | | September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Customer A | 23 % | * % | 10 % | * % |
| Customer B | 20 | * | 18 | * |
| Customer C | 15 | 22 | 14 | 18 |
| Customer D | 12 | 20 | 16 | 19 |
| Customer E | 11 | * | 16 | 10 |
| Customer F | * | 12 | * | 16 |
| Customer G | * | 10 | * | * |

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

Trade receivables from significant customers at September 30, 2011 totaled \$2,889,000. As of September 30, 2011, 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.

- 10 -

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, non-qualified stock options. The plans also allow DCT to issue restricted stock.

The following table sets forth, by the respective option plan, certain aspects of DCT's stock options as of September 30, 2011:

| 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 | 2,478,710 | 721,290 | 3,200,000 |
| 2006 Stock Option Plan | - | 2,500,000 | 2,500,000 | 2,449,000 | 51,000 | 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 | 2,515,000 | 985,000 | 3,500,000 |
| Key Personnel Option Grants | 7,875,000 | - | 7,875,000 | 6,017,315 | - | 6,017,315 |
| | 7,875,000 | 10,700,000 | 18,575,000 | 14,639,358 | 2,077,957 | 16,717,315 |

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 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2011 | 2010 | 2011 | 2010 |
| Selling, general and administrative | \$ 302 | \$ 212 | \$ 886 | \$ 568 |
| Research and development | 23 | 32 | 85 | 95 |
| Total | \$ 325 | \$ 244 | \$ 971 | \$ 663 |

At September 30, 2011, DCT had approximately \$1,290,000 of total unrecognized compensation cost related to unvested stock options. This cost is expected to be recognized over a weighted-average period of approximately 1.3 years.

- 11 -

Stock Option Activity and Outstanding

DCT had the following stock option activity during the nine months ended September 30, 2011:

| | Options | Weighted-Average Exercise Price |
|-----------------------------------|--------------|---------------------------------|
| Outstanding at December 31, 2010 | 15,244,498 | \$ 0.34 |
| Granted | 1,143,710 | 0.39 |
| Exercised | (98,850) | (0.01) |
| Cancelled | (1,650,000) | (0.40) |
| Outstanding at September 30, 2011 | 14,639,358 | \$ 0.34 |

The following table summarizes all options outstanding and exercisable by price range as of September 30, 2011:

| 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 | 2,142,315 | 0.6 | \$ 0.01 | 2,142,315 | \$ 0.01 |
| \$0.29-\$0.45 | 9,597,043 | 6.5 | \$ 0.32 | 5,207,076 | \$ 0.30 |
| \$0.60 - \$0.70 | 2,900,000 | 7.1 | \$ 0.68 | 1,500,000 | \$ 0.69 |
| | 14,639,358 | | | 8,849,391 | |

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 \$536,000 at September 30, 2011. The total intrinsic value of options outstanding at December 31, 2010 was \$3,462,000. The total intrinsic value for exercisable options was \$536,000 and \$2,024,000 at September 30, 2011 and December 31, 2010, respectively. The total intrinsic value for options exercised during the nine months ended September 30, 2011 was \$43,000.

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 taken into consideration in calculating diluted net income per common share for the three months ended September 30, 2011, but the impact did not change net income per share. Common stock equivalents were not considered in calculating diluted net loss per common share for the nine months ended September 30, 2011, or for the three and nine months ended September 30, 2010, as their effect would be anti-dilutive.

The computation of DCT's basic and diluted earnings per share for the three months ended September 30, 2011 is as follows (in thousands, except per share amounts):

| | |
|---|--------|
| Net income available to common shareholders (A) | \$620 |
| Weighted average common shares outstanding (B) | 20,578 |
| Dilutive effect of stock options and warrants | 2,063 |
| Weighted average common shares outstanding, assuming dilution (C) | 22,641 |
| Basic earnings per common share (A)/(B) | \$0.03 |
| Diluted earnings per common share (A)/(C) | \$0.03 |

- 12 -

The above calculation excluded 16,755,000 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

Common Stock Issuances - 2011

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

Common Stock Issuances - 2010

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 (“NCR Shares”) of the Company's common stock for an aggregate purchase price of \$4,000,000 (“Investment”). 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, as more fully described below.

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 NCR Option is exercisable at any time or from time to time for two years from the Purchase Date. The exercise price of the NCR 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 NCR 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 NCR Option exercise price then in effect.

Under the provisions of the Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging, the anti-dilution feature of the NCR Shares is a derivative instrument that requires bifurcation from the host contract and is recorded at fair value as a derivative liability. During all periods presented, the estimated fair value of the anti-dilution feature of the NCR Shares was de minimis.

Under the provisions of ASC 480, Distinguishing Liabilities from Equity, a financial instrument is a liability if the number of shares used to calculate the settlement amount is not fixed. If a financial instrument's terms provide for any potential adjustment, regardless of the probability of such adjustment(s) or whether such adjustments are in the entity's control, the settlement amount is not fixed. As the NCR Option contains a price protection provision (or down-round provision) that reduces the option's strike price in the event the Company issues additional shares at a more favorable price than the strike price, the NCR Option is recognized at fair value as a liability. The fair value of the NCR Option was estimated using a custom Binomial option pricing model with the following assumptions: 0.42% risk-free interest rate, expected volatility of 162%, expected dividend yield of 0%, and remaining life equal to the remaining contractual life of the option. Estimated fair value on the Purchase Date was \$1,544,000. As such, of the \$4,000,000

proceeds received from NCR, \$1,544,000 was booked as a stock option liability and the remaining proceeds were booked as stockholders' equity. See Note 9.

During August 2010, DCT issued 180,822 shares of common stock upon the cashless exercise of warrants. In connection with the cashless exercise, 434,178 warrants were cancelled.

- 13 -

Common Stock Repurchases

During September 2010, DCT's board of directors authorized DCT to repurchase ("DCT Stock Repurchase Plan") and retire \$2,500,000 of its common stock in open market transactions or privately negotiated transactions pursuant to Rule 10b-18 of the Securities Exchange Act of 1934, as amended.

Under this authorization, DCT repurchased 736,785 shares of common stock at a total cost of \$604,000 through September 30, 2010. DCT subsequently retired the shares. As such, the Company accounted for the repurchase shares by recording a reduction to common stock and additional paid-in capital for the total cost.

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 nine months ended September 30, 2011. For warrants issued during the nine months ended September 30, 2010, DCT estimated the fair value using the following weighted average assumptions: contractual term of two years, 0.6% risk-free interest rate, expected volatility of 285% and expected dividend yield of 0%.

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 \$60,000 during the three and nine months ended September 30, 2011, respectively; and \$0 and \$72,000 during the three and nine months ended September 30, 2010, respectively.

The following table summarizes certain aspects of DCT's outstanding warrants as of September 30, 2011:

| | Number of Shares | Exercise Price (\$) | Issuance Date | Expiration Date |
|-------------------------------------|---------------------------|------------------------|------------------|--------------------|
| Warrants Issued in Connection with: | Outstanding and Vested | | | |
| 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 9 – Fair Value

Under the provisions of the ASC Topic 820, Fair Value Measurements and Disclosures, DCT's stock option liability is adjusted to its fair value at the end of each reporting period using the Binomial option pricing model. As of September 30, 2011, DCT estimated the fair value using the following assumptions: 0.13% risk-free interest rate, expected volatility of 159%, 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.

The NCR Option 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 Months Ended September 30, | | As of and for the Nine Months Ended September 30, | |
|--|--|----------|---|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Beginning Balance - Stock Option Liability | \$ 541 | \$ – | \$ 811 | \$ – |
| Issuance of stock option (Note 8) | | 1,544 | | 1,544 |
| Unrealized loss (gain) included in net income (loss) (1) | (348) | 232 | (618) | 232 |
| Ending Balance- Stock Option Liability | \$ 193 | \$ 1,776 | \$ 193 | \$ 1,776 |

(1) Included as a component of non-operating income (expense).

Note 10 – Debt

Bank Line of Credit

As of September 30, 2011, DCT had a \$2,000,000 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 September 30, 2011) plus 1.0%. Interest payments are due monthly and all unpaid interest and principal is due in full on November 15, 2011.

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 September 30, 2011, DCT was in compliance with all LOC debt covenants and had unused borrowing capacity of \$1,700,000. See Note 14.

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 September 30, 2011, DCT’s LOC borrowing capacity was reduced from \$2,000,000 to \$1,700,000 to reflect the entire standby letter of credit. DCT’s LOC borrowing capacity will continue to be reduced by \$300,000 until the supplier no longer requires the guarantee, or until July 6, 2012, at which time the current guarantee terminates.

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 September 30, 2011, future minimum rental commitments under non-cancellable leases were as follows (in thousands):

| Year Ending September 30, | Future Minimum Lease Payments |
|------------------------------|--|
| 2012 | \$ 197 |
| 2013 | 239 |
| 2014 | 261 |
| 2015 | 280 |
| Thereafter | 23 |
| | \$ 1,000 |

Employment Agreements

DCT maintains employment agreements with certain of its executive officers and key employees. The agreements provide for termination payments, stock options, non-competition provisions, and other terms and conditions of employment. As of September 30, 2011, termination payments totaling \$1,457,000 remain in effect.

Research and Development Agreement

During the second quarter of 2011, the Company entered into an agreement (“Development Agreement”) with a customer to develop scanners to meet the customer’s specific product requirements. Revenue and the associated cost of revenue are recognized based on a percentage-of-completion estimate. During the three and nine months ended September 30, 2011, DCT recognized revenue of \$37,000 and \$56,000 based on an estimated percentage of completion. As of September 30, 2011, DCT had no 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 12 –Inventories

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

| | September 30, 2011 | December 31, 2010 |
|----------------|-----------------------|----------------------|
| Raw materials | \$ 244 | \$ 311 |
| Finished goods | 1,976 | 1,419 |
| | \$ 2,220 | \$ 1,730 |

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 nine months ended September 30, 2011 and 2010, 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 September 30, | | Nine Months Ended September 30, | |
|------------------|-------------------------------------|----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| U.S. | \$ 5,113 | \$ 3,250 | \$ 12,156 | \$ 9,443 |
| Europe and other | 140 | 177 | 517 | 644 |
| Asia | – | 112 | 11 | 182 |
| | \$ 5,253 | \$ 3,539 | \$ 12,684 | \$ 10,269 |

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

| | September 30, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
|--|-----------------------|----------------------|

| | | | | |
|---------------------|----|-------|----|-------|
| U.S. | \$ | 6,497 | \$ | 6,674 |
| Europe and other | | 386 | | 287 |
| Asia | | 63 | | 78 |
| | \$ | 6,946 | \$ | 7,039 |

- 16 -

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

Amended LOC

On November 9, 2011, DCT amended its LOC ("Amended LOC"). The Amended LOC increases the available borrowings from \$2,000,000 to \$3,000,000 and extends the maturity date to November 15, 2012. All other significant terms and conditions remain unchanged.

In connection with the Amended LOC, DCT agreed to pay the lender a loan origination fee of \$7,500.

Termination of Related-Party Consulting Arrangement

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 will continue to serve as a director on DCT's board of directors.

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, 2010 as filed with the Securities and Exchange Commission on March 16, 2011. 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 sections are 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 nine months ended September 30, 2011 compared to the three and nine months ended September 30, 2010. A brief description of certain aspects, transactions, and events is provided 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 nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010.
- **Contractual Obligations, Off-Balance-Sheet Arrangements, and Trends.** As of September 30, 2011, 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 as new technologies emerge. In support of our expansion strategy, we entered an agreement with Microtek International ("Microtek") on June 3, 2011. Microtek International ("Microtek") is a Taiwan-based multi-national designer, developer and manufacturer of proprietary scanner technology. The agreement ("Microtek Agreement") gives us exclusive rights to distribute four of Microtek's leading products in North America. The Microtek agreement immediately increases and augments DCT's already industry-leading image

capture offerings across a broad range of price points and functionality. We anticipate the new Microtek products to appeal to our existing customers as well as creating revenue opportunities with new customers.

- 18 -

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, 2010 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 nine months ended September 30, 2011 compared to the three and nine months ended September 30, 2010 (in thousands):

| | For the Three Months Ended | | | | For the Nine Months Ended | | | |
|---|----------------------------|----------|----------|------|---------------------------|-----------|----------|------|
| | 2011 | 2010 | \$ | % | 2011 | 2010 | \$ | % |
| Net sales | \$ 5,253 | \$ 3,539 | \$ 1,714 | 48 % | \$ 12,684 | \$ 10,269 | \$ 2,415 | 24 % |
| Cost of sales | 3,214 | 2,138 | 1,076 | 50 | 8,088 | 6,263 | 1,825 | 29 |
| As a percentage of sales | 61.2 % | 60.4 % | | | 63.8 % | 61.0 % | | |
| Selling, general and administrative expense | 1,454 | 1,332 | 122 | 9 | 4,302 | 3,284 | 1,018 | 31 |
| Research and development expense | 300 | 263 | 37 | 14 | 931 | 807 | 124 | 15 |
| Non-operating income (expense) | 335 | (234) | NM | NM | 617 | (218) | NM | NM |

NM = Not Meaningful

Net Sales

Net sales grew for all periods presented resulting from a 32% and 17% increased number of units sold for the three and nine months ended September 30, 2011 compared to the three and nine months ended September 30, 2010, respectively. The increase is primarily attributable to increased sales to existing customers, although the customer mix varies from period to period. Most of the net sales growth as compared to prior year was driven by three customers, and five customers, respectively, in the three months and nine months periods ended September 30, 2011. Our weighted average selling price was positively impacted by the mix of products and product configurations sold, offset slightly by certain volume-related discounts.

As a percentage of total sales, international sales decreased to 3% and 4% for the three and nine months ended September 30, 2011, respectively, from 8% for both for the three and nine months ended September 30, 2010. The decrease was attributable to the significant increase in domestic revenues. The decrease in our international sales expressed in absolute dollars for all periods presented was attributable to the sluggish European economy and our transition to a new product distributor in Asia.

Sales attributable to significant customers (customers who represent more than 10% of our sales) as a percentage of total sales increased to 81% and 74% for the three and nine months ended September 30, 2011, respectively, from 64% and 63% for the three and nine months ended September 30, 2010. This increase in percentage of sales attributable to significant customers is largely due to the marked increase in sales to a small number of existing customers, as discussed above. See "Note 4— Concentration of Credit Risk and Major Customers" in Part I 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 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. To a lesser extent, cost of sales also includes engineering services, shipping costs, software royalties, depreciation of manufacturing equipment, and labor for scanners assembled in the U.S. Cost of sales as a percentage of sales during both the three and nine months ended September 30, 2011 compared to the three and nine months ended September 30, 2010 increased as a result of the mix of products sold and certain volume-related discounts.

- 20 -

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 excess and obsolete inventories.
- Our ability to advance to the next technology faster than our competitors.

Selling, General and Administrative Expense

Selling, general and administrative expenses consist primarily of personnel-related expenses, stock-based compensation costs, and facilities-related expenses. It also includes outside professional services (such as investor relations, personnel recruiting, IT consulting and audit fees), travel-related costs, and fees paid to non-executive members of our board of directors. To a lesser extent, it includes market development and promotional funds for our retail distribution channels, tradeshow, and website support.

The increase in selling, general and administrative expense during the three and nine months ended September 30, 2011 compared to the three and nine months ended September 30, 2010 was primarily attributable to the following:

- Increased headcount and higher salaries to attract and retain talent required for business expansion.
- Increased stock-based compensation costs (a non-cash charge). Stock-based compensation cost was \$302,000 and \$212,000 for the three months ended September 30, 2011 and 2010, respectively. Stock-based compensation cost was \$886,000 and \$568,000 for the nine months ended September 30, 2011 and 2010, respectively. See “Note 6 – Equity Incentive Plans” in Part I, Item 1 of this Form 10-Q.
- Increased consulting costs due to IT upgrades, personnel recruitment, and fees paid to the non-executive members of our board of directors.
- Increased travel associated with our efforts to expand our (i) product offerings, (ii) customer base, as well as sales to existing customers, and (iii) presence in international markets.

The above increases were partially offset by a non-recurring \$400,000 fee expensed by DCT during the three months ended September 30, 2010. The fee was for entering a consulting agreement to help DCT expand sales.

We anticipate that future selling, general and administrative expenses will fluctuate as we concentrate on growing our business and revenue base.

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 nine months ended September 30, 2011 compared to the three and nine months ended September 30, 2010 was primarily attributable to increased personnel expenses for internal engineers and our newly-hired chief technology officer.

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 component of our non-operating income (expense) was a non-cash gain of \$348,000 and \$618,000 during the three and nine months ended September 30, 2011, respectively, to reflect the decreased fair value of our stock option liability. Similarly, the most significant component of our non-operating income (expense) during both the three and nine months ended September 30, 2010 was a \$232,000 non-cash loss related to the increased fair value of our stock option liability. See “Note 9 – Fair Value” in Part I, Item 1 of this Form 10-Q. Generally, we will report a non-cash gain during any accounting period in which there is a reported decrease in the value of our common stock, and a non-cash loss during any accounting period in which there is a reported increase in the value of our common stock as quoted on the OTC Bulletin Board.

Other less impactful components include realized gain and loss on foreign currency transactions. Additionally, the nine months ended September 30, 2010 includes cash received as settlement for two lawsuits and other legal issues, and interest expense on our line of credit.

Liquidity and Capital Resources

At September 30, 2011, principal sources of liquidity included cash and cash equivalents of \$913,000 and an available borrowing capacity of \$1,700,000 on our bank line of credit. To support purchases under the Microtek Agreement, DCT arranged for the issuance to Microtek of a \$300,000 standby letter of credit that may be drawn upon by Microtek in the event that timely payment is not made for the products purchased. As a result, DCT’s LOC borrowing capacity was reduced from \$2,000,000 to \$1,700,000 to reflect the entire standby letter of credit. DCT’s LOC borrowing capacity will continue to be reduced by \$300,000 until Microtek no longer requires the guarantee, or until July 6, 2012, at which time the current guarantee terminates.

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

| | As of or for the Nine Months Ended September 30, | |
|--|--|--------|
| | 2011 | 2010 |
| Cash (used) provided by operating activities | \$ (1,382) | \$ 525 |
| Cash used by investing activities | (28) | (52) |
| Cash provided by financing activities | 1 | 3,136 |
| Net (decrease) increase in cash and cash equivalents | (1,409) | 3,609 |

| | | | | |
|--|----|-------|----|-------|
| Cash and cash equivalents at the beginning of the period | | 2,322 | | 328 |
| Cash and cash equivalents at the end of the period | \$ | 913 | \$ | 3,937 |
| Working capital | \$ | 5,253 | \$ | 6,440 |

Operating activities: During the nine months ended September 30, 2011, our operating activities used \$1,382,000 of cash. This was a result of our \$20,000 net loss, \$483,000 of net non-cash expenses, and \$1,845,000 net cash used by changes in operating assets and liabilities. During the nine months ended September 30, 2010, our operating activities provided \$525,000 of cash. This was a result of our \$305,000 net loss, \$1,092,000 of net non-cash expenses, and \$262,000 net cash used by changes in operating assets and liabilities.

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

Unless noted below, the changes in operating assets and liabilities during both the nine months ended September 30, 2011 and 2010, were indicative of the normal operational fluctuations related to the timing of product shipments, trade receivable collections, inventory management, and timing of vendor payments.

- Inventories increased during the nine months ended September 30, 2011 due to timing of shipments from the factory and to customers, and to support our product offering expansion efforts. In the future, our inventory levels may fluctuate due to our goal of product expansion and growth. Our future product expansion will be balanced against the risk of slow moving or excess inventory levels.
- 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.

We expect future cash provided (used) by operating activities to fluctuate primarily as a result of: expansion efforts, variations 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 nine months ended September 30, 2011 and 2010 included capital purchases to support normal business operations.

Financing activities: During the nine months ended September 30, 2011, financing activities consisted of proceeds received from the exercise of employee stock options. During the nine months ended September 30, 2010, financing activities consisted of (i) \$4,000,000 proceeds from the sale of our common stock, less \$27,000 of related stock issuance costs, (ii) \$225,000 payoff of our line of credit, (iii) \$604,000 cash paid for the repurchase of our common stock, and (iv) \$8,000 deferred financing costs.

Cash and Working Capital Requirements

Our strengthened financial position has provided us with the ability to actively pursue growth opportunities including the aforementioned Microtek Agreement. While this new strategic relationship increases our product offerings, resulting in significant revenue opportunities from new and existing customers, it may constrain working capital in the near term.

In addition to the new Microtek relationship, we anticipate entering into other strategic relationships that will enhance and expand our current product offerings, which may increase our revenues. We believe the anticipated expansion into these new, but related, market segments 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 our anticipated growth through the next 12 months.

Contractual Obligations

The following table summarizes our contractual obligations at September 30, 2011, and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in thousands):

- 23 -

| | Total | Less Than One Year | One – Three Years | Four – Five Years |
|------------------------------------|----------|-----------------------|----------------------|----------------------|
| Operating lease obligations | \$ 1,000 | \$ 197 | \$ 780 | \$ 23 |
| Line of credit (1) | – | – | – | – |
| Total contractual cash obligations | \$ 1,000 | \$ 197 | \$ 780 | \$ 23 |

(1) As of September 30, 2011, DCT had a \$2,000,000 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 September 30, 2011) plus 1.0%. Interest payments are due monthly and all unpaid interest and principal is due in full on November 15, 2011.

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 September 30, 2011, DCT was in compliance with all LOC debt covenants and had unused borrowing capacity of \$1,700,000.

On November 9, 2011, DCT amended its LOC (“Amended LOC”). The Amended LOC increases the available borrowings from \$2,000,000 to \$3,000,000 and extends the maturity date to November 15, 2012. All other significant terms and conditions remain unchanged.

Off-Balance Sheet Arrangements

At September 30, 2011 we had no material off-balance sheet arrangements, other than our operating leases.

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 September 30, 2011, which are likely to have a material effect on our future liquidity.

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, 2010 as filed with the Securities and Exchange Commission on March 16, 2011.

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

None

Item 3 - Defaults Upon Senior Securities

None.

Item 4 – Removed and Reserved

Item 5 - Other Information

None.

- 26 -

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 |

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: November 14, 2011

/s/ David P. Clark

David P. Clark, Chief Executive Officer

Date: November 14, 2011

/s/ M. Carolyn Ellis

M. Carolyn Ellis

Chief Financial Officer