DOCUMENT CAPTURE TECHNOLOGIES, INC.
Form 10-Q
May 09, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended March 31, 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 incorporation or organization)	(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 x 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 x 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 x

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

The number of shares of Common Stock outstanding as of May 9, 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 QUARTER ENDED MARCH 31, 2012

INDEX

PART I. FINANCIAL INFORMATION

Item 1 - Financial Statements

DOCUMENT CAPTURE TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	March 31, 2012 (unaudited)	December 31, 2011 *
ASSETS		
Current assets:		
Cash and cash equivalents	$ 903	$ 2,455
Trade receivables	3,014	2,207
Inventories, net	2,515	2,876
Prepaid expenses and other current assets	182	226
Total current assets	6,614	7,764
Other non-current assets	36	36
Fixed assets, net	131	125
Total assets	$ 6,781	$ 7,925
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Line of credit	$ –	$ –
Trade payables to related parties	289	1,014
Trade payables and other accrued expenses	290	717
Accrued compensation and benefits	414	444
Income tax payable	–	23
Total current liabilities	993	2,198
Stock option liability	347	502
Long-term deferred rent	118	113
Commitments and contingencies (Note 11)		
Stockholders’ equity:		
Preferred stock $.001 par value, 2,000 authorized, 0 issued and outstanding at March 31, 2012 and December 31, 2011	21	21

Common stock $.001 par value, 50,000 authorized, 20,678 and 20,578 issued and outstanding at March 31, 2012 and December 31, 2011, respectively		
Additional paid-in capital	38,558	38,290
Accumulated deficit	(33,256)	(33,199)
Total stockholders' equity	5,323	5,112
Total liabilities and stockholders' equity	$ 6,781	$ 7,925

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

DOCUMENT CAPTURE TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(in thousands, except per share amounts)

	Three Months Ended March 31, 2012	2011
Net sales	$4,410	$3,582
Cost of sales	2,709	2,377
Gross profit	1,701	1,205
Operating expenses:		
Selling, general and administrative	1,434	1,417
Research and development	467	317
Total operating expenses	1,901	1,734
Operating loss	(200)	(529)
Non-operating income (expense), net	143	201
Net loss	$(57)	$(328)
Earnings per common share – basic and diluted	$(0.00)	$(0.02)
Weighted average common shares outstanding:		
Basic	20,597	20,512
Diluted	20,597	20,512

DOCUMENT CAPTURE TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	Three Months Ended March 31,	
	2012	2011
Operating activities:		
Net loss	$(57)	$(328)
Adjustments to reconcile net (loss) income to net cash used by operating activities:		
Depreciation expense included in operating expenses	10	11
Depreciation expense included in cost of sales	10	11
Stock-based compensation cost – options	247	322
Fair value of warrants issued for services rendered	20	21
Interest expense attributable to amortization of debt issuance costs	2	1
Change in fair value of stock option liability	(155)	(193)
Changes in operating assets and liabilities:		
Trade receivables	(807)	716
Inventories	361	(490)
Prepaid expenses and other current assets	16	130
Other non-current assets	–	6
Trade payables to related parties	(725)	(107)
Trade payables and other current liabilities	(457)	(484)
Income taxes payable	(23)	(100)
Deferred revenue and customer deposits	–	(23)
Long-term deferred rent	5	12
Cash used by operating activities	(1,553)	(495)
Investing activities:		
Capital expenditures	–	(24)
Cash used by investing activities	–	(24)
Financing activities:		
Proceeds from exercise of common stock options	1	1
Cash provided by financing activities	1	1
Net decrease in cash and cash equivalents	(1,552)	(518)
Cash and cash equivalents at beginning of period	2,455	2,322
Cash and cash equivalents at end of period	$903	$1,804

Supplemental disclosures of cash flow information:

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

-6-

DOCUMENT CAPTURE TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Unaudited)

Note 1 – Background and Basis of Presentation

Organization

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

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

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

Basis of Presentation

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

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for all periods presented have been made. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results may differ from these estimates. The results of operations for the period ended March 31, 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.

DOCUMENT CAPTURE TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Unaudited)

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.

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 $2,339,000 and $2,539,000 for the three months ended March 31, 2012 and 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 $289,000 and $1,014,000 at March 31, 2012 and December 31, 2011, respectively.

Net Sales

During the three months ended March 31, 2011, DCT recorded net sales and related cost of sales totaling $11,000 and $10,000, respectively for finished scanners sold to Scanner Manufacturers. 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.

Legal Services Agreement

In 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 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 for both the three months ended March 31, 2012 and 2011. The Agreement may be cancelled by either party with 30 days prior written notice.

DOCUMENT CAPTURE TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Unaudited)

Consulting Services

In February 2011, DCT entered into a month-to-month product development arrangement with Darwin Hu, a current member of DCT's board of directors, whereby Mr. Hu assisted DCT with expanding DCT's product offerings. Pursuant to the arrangement, Mr. Hu was paid $12,500 during the three months ended March 31, 2011. 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.

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. The License can be cancelled by either party with 90 days written notice. DCT uses the office space for all meetings of the board of directors and all shareholder meetings. In connection with the License, the Company paid BDA an upfront license fee of $50,000 as payment in full. The $50,000 payment was capitalized and is being amortized, using the straight-line method, to selling, general and administrative expense over the term of the License.

In connection with the License, DCT recorded rent expense of $6,000 for both the three months ended March 31, 2012 and 2011.

During December 2011, DCT's Audit Committee approved a one-year extension of the License. In connection with the extension, DCT paid BDA $12,500 during December 2011 and $12,500 during April 2012. Both payments were capitalized and will be 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.

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. Interest bearing accounts are at each institution are insured by the Federal Deposit Insurance Corporation ("FDIC") up to $250,000. Non-interest bearing accounts are 100% insured. As of March 31, 2012, DCT had consolidated balances of approximately $70,000, which were not guaranteed by 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 March 31,			
	2012		2011	
Customer A	25	%	12	%
Customer B	21		21	
Customer C	19		*	
Customer D	10		25	

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

Trade receivables from these customers totaled $2,520,000 at March 31, 2012. As of March 31, 2012, all the Company's trade receivables were unsecured.

DOCUMENT CAPTURE TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Unaudited)

Note 5 – Concentration of Supplier Risk

Manufacturing. Historically, DCT has purchased substantially all its finished scanner imaging products from one vendor that is also a wholly-owned subsidiary of the parent company of DCT's former majority stockholder. See Note 3. If this vendor became unable 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, which could harm DCT's business, operating results and financial condition. Management is currently investigating ways to mitigate this existing risk.

Note 6 – Equity Incentive Plans

General

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

The following table sets forth, by the respective option plan, certain aspects of DCT's stock options as of March 31, 2012:

	Option Approval Method			Options Outstanding and Options Available		
Description	Board of Directors	Board of Directors	Total	Outstanding	Available For	Total

		and Shareholders			Future Grant	
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	2,299,000	201,000	2,500,000
2009 Stock Option Plan	–	1,500,000	1,500,000	1,179,333	320,667	1,500,000
2010 Stock Option Plan	–	3,500,000	3,500,000	2,500,000	1,000,000	3,500,000
Key Personnel Option Grants	7,875,000	–	7,875,000	5,917,315	–	5,917,315
	7,875,000	10,700,000	18,575,000	14,374,358	2,242,957	16,617,315

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 included in DCT's Statements of Operations (*in thousands*):

	Three Months Ended March 31,	
	2012	2011
Selling, general and administrative	$ 233	$ 291
Research and development	14	31
	$ 247	$ 322

DOCUMENT CAPTURE TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Unaudited)

At March 31, 2012, DCT had approximately $692,000 of total unrecognized compensation cost related to unvested stock options. This cost is expected to be recognized over a weighted-average period of approximately one year.

Stock Option Activity and Outstanding

DCT had the following stock option activity during the three months ended March 31, 2012:

	Options	Weighted-Average Exercise Price
Outstanding at December 31, 2011	14,524,358	$ 0.34
Granted	-	-
Cancelled	50,000	0.32
Exercised	100,000	0.01
Outstanding at March 31, 2012	14,374,358	$ 0.35
Vested or expected to vest at March 31, 2012	14,374,358	$ 0.35

The following table summarizes all options outstanding and exercisable by price range as of March 31, 2012:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding**	Weighted-Average Remaining Contractual Life (Years)	**Weighted-Average Exercise Price**	**Number Exercisable**	**Weighted-Average Exercise Price**
$0.01	2,042,315	0.1	$ 0.01	2,042,315	$ 0.01
$0.29-$0.45	9,432,043	5.9	$ 0.32	5,884,214	$ 0.32
$0.60 - $0.70	2,900,000	6.6	$ 0.68	2,200,000	$ 0.68

14,374,358	10,126,529

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) at March 31, 2012 was approximately $1,081,000. The total intrinsic value of options outstanding at December 31, 2011 was $1,546,000. The total intrinsic value for exercisable options was $953,000 and $1,303,000 at March 31, 2012 and December 31, 2011, respectively. The total intrinsic value was $27,000 for options exercised during the three months ended March 31, 2012.

Note 7 – Fair Value

Under the provisions of the Accounting Standards Codification 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 March 31, 2012, DCT estimated the fair value using the following assumptions: 0.15% risk-free interest rate, expected volatility of 223%, 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.

DOCUMENT CAPTURE TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Unaudited)

The NCR Option fair value is measured using Level 3 inputs, unobservable inputs to the valuation methodology that 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 March 31,	
	2012	2011
Beginning Balance - Stock Option Liability	$ 502	$ 811
Unrealized gain included in net loss [1]	(155)	(193)
Ending Balance- Stock Option Liability	$ 347	$ 618

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

Note 8 – Earnings per Common Share - Basic and Diluted

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

Common stock equivalents of 3,121,000 and 4,937,000 were not considered in calculating DCT's diluted earnings per common share for the three months ended March 31, 2012 and 2011, respectively as their effect would be anti-dilutive.

Note 9 – Equity

Common Stock

DCT issued 100,000 and 98,850 shares of common stock upon the exercise of employee stock options during the three months ended March 31, 2012 and 2011, respectively.

Common Stock Warrants

In certain instances, DCT issues warrants for consulting services. DCT amortizes the fair value of the warrants, as calculated on the issuance date using the Black-Scholes valuation model, over the service period. In connection with such common stock warrants issued and outstanding, DCT charged selling, general and administrative expense with the offset credit to additional paid in capital for $20,000 and $21,000 during the three months ended March 31, 2012 and 2011, respectively.

DCT did not issue any common stock warrants during the three months ended March 31, 2012 or the three months ended March 31, 2011.

The following table summarizes certain aspects of DCT's outstanding warrants as of March 31, 2012:

DOCUMENT CAPTURE TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Unaudited)

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

Note 10 – Debt

Bank Line of Credit

As of March 31, 2012, DCT had a $3,000,000 line of credit ("LOC") at a commercial bank. Borrowings under the LOC are limited to 80% of eligible accounts receivable less the aggregate face amount of all outstanding letters of credit, cash management services, and foreign exchange contracts. The interest rate is prime (3.25% at March 31, 2012) plus 1.0%. Interest payments are due monthly and all unpaid interest and principal is due in full on November 15, 2012.

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

As of March 31, 2012, DCT was in compliance with all LOC debt covenants and had unused borrowing capacity of $2,044,000.

Standby Letter of Credit

In June 2011, DCT entered into a distribution agreement that required the Company to provide a $300,000 standby letter of credit. At March 31, 2012, DCT's LOC borrowing capacity was reduced from $2,344,000 to $2,044,000 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 March 31, 2012, future minimum rental commitments under non-cancellable leases were as follows (*in thousands*):

Year Ending	Future Minimum Lease Payments
March 31,	
2013	$ 218
2014	251
2015	270
2016	164
	$ 903

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

DOCUMENT CAPTURE TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Unaudited)

Employment Agreements

DCT maintains employment agreements with certain of its executive officers that provide for a base salary and annual bonus to be determined by the Board of Directors. The agreements also provide for termination payments, stock options, non-competition provisions, and other terms and conditions of employment. In addition, DCT maintains employment agreements with other key employees with similar terms and conditions. As of March 31, 2012 termination payments totaling $1,202,000 remain in effect.

Litigation, Claims and Assessments

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

Note 12 –Inventories

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

	March 31, 2012	December 31, 2011
Raw materials	$ 833	$ 803
Finished goods	1,715	2,106
	2,548	2,909
Less: Inventory allowance	(33)	(33)
	$ 2,515	$ 2,876

Note 13 – Segment and Geographic Information

Segment Information

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

Geographic Information

During the three months ended March 31, 2012 and 2011, DCT recorded net sales throughout the U.S., Asia and Europe 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 March 31,	
	2012	2011
U.S.	$ 4,147	$ 3,367
Europe	263	204
Asia	–	11
	$ 4,410	$ 3,582

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

DOCUMENT CAPTURE TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Unaudited)

	March 31, 2012	December 31, 2011
U.S.	$ 6,371	$ 7,357
Europe and other	343	516
Asia	67	52
	$ 6,781	$ 7,925

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

Note 14 – Subsequent Events

Stock Option Grants

On April 2, 2012, DCT's Compensation Committee granted an aggregate of 200,000 options to certain employees and non-management board members. The options are exercisable for a period of ten years from the date of grant at an exercise price of $0.35 per share. Of the total options granted, 100,000 fully vest on December 31, 2012 and 100,000 vest as follows: one-third on April 3, 2013, one-third on April 3, 2014 and one-