

DOCUMENT CAPTURE TECHNOLOGIES, INC.
Form 10-K
March 31, 2010

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

FORM 10-K

☒ ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2009

☐ TRANSITION REPORT UNDER 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.
(Name of small business issuer in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

408-436-9888 ext. 207
(Issuer's telephone number, including area code)

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$0.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or

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information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the 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 aggregate market value of the issuer’s voting and non-voting common equity held by non-affiliates (9,095,256 shares) was approximately \$3,638,102, based on the average closing bid and ask price of \$0.40 for such common equity on June 30, 2009.

As of March 15, 2010, there were outstanding 19,406,270 shares of the issuer’s Common Stock, par value \$0.001.

DOCUMENTS INCORPORATED BY REFERENCE

None

FORWARD LOOKING STATEMENTS

Some of the statements under “Management’s Discussion and Analysis of Financial Condition or Plan of Operations,” and “Description of Business” in this Annual Report on Form 10-K are 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 Annual 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 Annual Report to conform these statements to actual results.

DOCUMENT CAPTURE TECHNOLOGIES, INC

FORM 10-K

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2009

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PART I

ITEM 1. BUSINESS

Overview

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

Syscan, Inc., our 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, we achieved many technical milestones and were granted numerous patents for our linear imaging technology. Our patented CIS and mobile imaging scanner technology provides high quality images at extremely low power consumption levels allowing us to deliver compact scanners in a form that is simple to use with a computer and or integrate into new or existing systems where there is need for a small footprint lightweight device to scan documents.

Our business model was developed and continues to evolve 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:

- Bank note and check verification (remote capture deposit or "RDC");
 - Document and information management;
 - Identification card scanners;
 - Passport security scanners;
 - Business card readers;
 - Barcode scanning; and
- Optical mark readers used in lottery terminals.

In the past ten years we have grown to be one of the largest manufacturers of page-fed scanning devices worldwide, and we sell to several major brand companies including AMBIR TECHNOLOGY, BRIDGEPORT TECHNOLOGIES, BROTHER INTERNATIONAL, BURROUGHS, NCR, NEWELL RUBBERMAID/DYMO-CARDSCAN, UNISYS, and VISIONEER. Our vertically integrated design and manufacturing business model allows our customers to introduce new products to the market quickly and efficiently.

Current Market Opportunities, Strategies and Products

In the past decade, information management, including how information is retrieved, stored, shared and disseminated, has become increasingly important, and in many instances critical, for all Enterprises worldwide.

Confronted by exponentially increasing information through more and more channels, Enterprises employ a variety of resources for managing information. Our document/image-capture products can help transform business-critical information from paper, faxed and electronic forms, documents and transactions into a manageable digital format. Our solutions can manage the processing of millions of forms, documents and transactions annually, converting their content into information that is usable in database, document, content and other information

management systems. We believe that our document/image-capture products enable organizations to reduce operating costs, obtain higher information accuracy rates and speed processing times.

Our document/image-capture solutions offer Enterprises a cost-effective and accurate alternative to manual data entry, a traditional approach that is typically a labor-intensive, time-consuming and costly method of managing the input of information into the Enterprise. Organizations can utilize our solutions to capture and store information electronically, and extract the meaningful content or data in a way that preserves the data's accuracy. As a result, we believe there is significant growth opportunity for our solutions to help simplify the way Enterprises manage information as well as other business applications.

Currently, all of our revenue is generated from sales of our document/image-capture products. Net revenue for the previous three years was (in thousands):

Year Ended	Net Revenue
December 31, 2009	\$ 11,529
December 31, 2008	11,643
December 31, 2007	15,023

We offer several different image scanning product groups to meet the diverse needs of our customers. Currently, all of our products are based on the same unique patented and proprietary technology, and our product groups vary from one another by various features and configurations. Our most popular product groups include our trademarked DocketPORT and TravelScan line of products.

DocketPORT®

Our DocketPORT product group is in its fourth generation of compact document/image-capture devices. Specific features of this product group include:

- High-speed Universal Serial Bus (“USB”) powered;
- True duplex scanning capability (several models scan both sides of a two-sided document at once);
 - 600 dots per inch (“DPI”) optical resolution;
 - Minimal power consumption;
 - Small footprint;
 - Extremely lightweight;
- Compliant with Restriction of Hazardous Substance (“RoHS”);
- Internal 48-bit analog-to-digital conversion for three-color channels (red, green and blue);
 - No power adapter required; and
- Variations that can scan any size document from business cards to legal size documents.

TravelScan®

Our TravelScan products are entry-level document management products. These lightweight and convenient scanners are powered via USB cable. Our TravelScan products can be conveniently carried alongside laptops and require minimal additional work space. These products enable users to fax, email and organize all business documents with the "touch of a button." Specific features include:

- Full-Speed USB powered;
- 300 dots per inch (“DPI”) optical resolution;
- Minimal power consumption;
 - Small footprint;
 - Extremely lightweight; and
- RoHS-Compliant with Restriction of Hazardous Substance.

Sales, Marketing and Distribution

Our sales and marketing efforts are designed to serve our direct customer base, rather than the end user of our products. We market and sell our products both domestically and internationally through a global network of more than 45 independent distributors and channel partners in North America, Europe and Asia. We select these independent entities based on their ability to provide effective field sales, marketing communications and technical

support to our targeted markets. In addition, our products are sold through several retail and Internet-based channels.

Competition

We had several direct competitors to our document/image-capture products, in major worldwide markets (North America, Europe and Asia) during the year ended December 31, 2009. To maintain our competitive advantage, we maintain a high level of investment in research and development, and focus on factory efficiency. This allows us to provide superior time-to-market product cycles with the goal of manufacturing and delivering products to customers virtually defect free.

We believe that our competitive strengths include:

- Product quality and performance;
- Patented and proprietary-based products;
- Favorable and well-established reputation, experience and presence in the USB-powered document/image-capture devices market;
- Superior customer relationships that allow us to identify and work closely with customers to meet market demands;
- Vertical integration design and manufacturing business model which reduces the time to introduce a new or improved product to the market; and
- Broad distribution channels.

Manufacturing and Raw Material Supply

Manufacturing. We purchase the majority of our finished scanner imaging products from Shenzhen Syscan Technology (“SST”), a wholly-owned subsidiary of Syscan Technology Holdings Limited (“STH”). SST was DCT’s majority shareholder until July 2008. As of December 31, 2009, SST held less than 20% of DCT’s outstanding common stock. See Part III, “Item 13: Certain Relationships and Related Transactions, and Director Independence.”

Historically, we have purposely limited the manufacturing of our product to SST, as this gives us better control over both the quality and cost of our product. We have established a pricing agreement with SST, which is negotiated periodically. From the early stages of product design and development, DCT engineers worked closely with SST’s production team to ensure optimal and cost-effective manufacturing. The strategy of using only one subcontract manufacturer could be disadvantageous if SST becomes unable or unwilling to provide products to us in a timely manner. If this happens, we estimate it would take us approximately six to twelve months to establish a new subcontract manufacturer. To mitigate this exposure, we provide to SST most of the critical components and tooling required to manufacture our proprietary products.

At the end of January 2010, SST announced a relocation of its primary manufacturing facility, currently located in Shenzhen China, to Wuhan, Hubei China. The purpose of the relocation relates directly to an opportunity for SST to reduce its direct and overhead costs. As of the date of this filing and based on information provided to it by SST, DCT anticipates the new manufacturing facility to be fully functional by April 2011 and that the relocation will have minimal impact to the manufacturing process and DCT’s operations.

Raw Materials. We do not have any long-term or exclusive purchase commitments with any of our suppliers.

SST purchases the raw materials, parts and components with the exception of the critical components discussed above, which we provide. A limited number of components included in our products are obtained from a single supplier or a small group of suppliers. Some controller chips are sole-sourced, as they are specialized devices that can effectively control the cost of our product. To reduce the risk associated with using a sole supplier, we attempt to maintain strategic inventories of these sole-sourced components. Where possible, we also work with secondary suppliers to qualify additional sources of supply.

To date, we have been able to obtain adequate supplies of the components used in the production of our document/image-capture products in a timely manner from existing sources. If in the future we are unable to obtain sufficient quantities of required materials, components or subassemblies, or if such items do not meet our quality standards, delays or reductions in product shipments could occur, which could harm our business, financial condition and results of operations.

Customers

A small number of our customers have historically accounted for a substantial portion of our net sales. Total sales to significant customers (customers who represent more than 10% of our net sales) were 64% and 82% during the years ended December 31, 2009 and 2008, respectively. See Note 1 included in Part II, "Item 8: Financial Statements." Our largest customer rankings and their respective contributions to our net sales have varied and will likely continue to vary from period to period. However, we expect that our largest customers will continue to account for a substantial portion of our net sales in the foreseeable future. As we continue to expand our customer base, we expect the concentration of sales to be more evenly distributed among our largest customers, thus reducing our exposure to any single customer.

Currently, we do not have agreements with any of our key customers that contain long-term commitments to purchase specified volumes of our products. We typically sell products pursuant to purchase orders that customers can generally defer without incurring a significant penalty. We believe that maintaining and continuing to strengthen customer relationships will play an important role in maintaining our leading position in the document/image-capture market.

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Intellectual Property

While the success of our business depends more on such factors as our employees' technical expertise and innovative skills, the success of our business also relies on our ability to protect our proprietary technology. Accordingly, we seek to protect our intellectual property rights in a variety of ways. Obtaining patents on our innovative technologies is one such way. We have multiple patents covering our document/image-capture technologies. These patents do not begin to expire until 2017.

Another way we seek to protect our proprietary technology and other proprietary rights is by requiring our employees and contractors to execute confidentiality and invention assignment agreements. We also rely on employee and third-party nondisclosure agreements and other intellectual property protection methods, including proprietary know-how, to protect our confidential information and our other intellectual property.

Compliance with Environmental, Health and Safety Regulations

DCT and its product manufacturer have established an ongoing product surveillance program in coordination with standards set by Underwriters Laboratories, Canadian Standards Association, CB Safety Standards, Federal Communication Commission (FCC class B), Community European (CE mark) and VCCI compliance (Japan). In July 2006, the European Union ("EU") began requiring all electronics products sold within the EU to be RoHS compliant pursuant to the European Directive 2002/95/EC as amended by European Directive 2003/108/EC(e). Beginning in January 2006, all DCT products offered were RoHS compliant.

Research and Development

We have historically devoted a significant portion of our financial resources to research and development programs to both enhance our current products and create new unique products, and we expect to continue to allocate significant resources to these efforts.

Our research and development expenses were \$1,013,000 and \$712,000 for the years ended December 31, 2009 and 2008, respectively. To date, all research and development costs have been expensed as incurred.

Our future success will depend, in part, on our ability to anticipate changes, enhance our current products, develop and introduce unique new products that keep pace with technological advancements and address the increasingly sophisticated needs of our customers. We intend to continue to develop our technology and innovative products to meet our customers document capture demands.

Seasonal Trends

Our sales generally have followed a slightly seasonal trend. Historically, our sales have been higher in the second half of the year than in the first half of the year. This seasonal trend has occurred during the past several years, but there can be no assurance that it will continue in the future.

Employees

As of December 31, 2009, we employed 22 employees on a full-time basis; 17 employees were located in the United States, 3 were located in China and 2 were located in Europe. Of the total, 7 were in product research and development and 15 were in sales, service, and administration. None of our employees are represented by unions or collective bargaining agreements. We have experienced no work stoppages and believe that our employee relations are good.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any document we file with the Commission at the Commission's public reference room at 100 F Street, N.E., Washington, D.C. 20549. Please call the Commission at 1-800-SEC-0330 for further information on the public reference rooms. Our Commission filings are also available to the public from the Commission's Website at www.sec.gov.

We make available free of charge our annual, quarterly and current reports, proxy statements and other information upon request. To request such materials, please contact our Corporate Secretary at 1798 Technology Drive Suite 178, San Jose, California 95110 or call 1-408-213-3707.

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Additionally, many reports and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our website at www.docucap.com as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Information on our website and other information that can be accessed through our website are not part of this report.

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ITEM 1A. RISK FACTORS

Risks Relating to Our Business

A significant percentage of our revenue is derived from sales to a few large customers, and if we are not able to retain these customers, or they reschedule, reduce or cancel orders, or delay or default on payments, our revenues would be reduced and our financial condition and cash flows would suffer.

Total sales to significant customers (customers who represent more than 10% of our net sales) were 64% and 82% during the years ended December 31, 2009 and 2008, respectively. See Note 1 included in Part II, “Item 8: Financial Statements.” We expect that our largest customers will continue to account for a substantial portion of our net sales for the foreseeable future. None of our customers are obligated to purchase a minimum number of our products in the aggregate or during any particular period. We cannot provide assurance that any of our customers will continue to purchase our products at past or current levels.

The Company has experienced a history of recurring operating losses and may continue to incur losses for the foreseeable future.

Our net loss attributable to common stockholders totaled \$291,000 and \$422,000 for the years December 31, 2009 and 2008, respectively. Our accumulated deficit as of December 31, 2009 was \$33,122,000. We cannot provide assurance that we can achieve profitability in the future.

We currently subcontract the manufacturing of our image-capture products to one company and this reliance on one company exposes us to risk which could damage our reputation and adversely affect our business.

If our manufacturer (see Part III, “Item 13: Certain Relationships and Related Transactions, and Director Independence”) becomes unable or unwilling to provide products to us in a timely manner, we may not be able to deliver our products to customers on time, which could increase our costs, damage our reputation or result in the loss of our customers. Although we have the right to utilize other manufacturers at any time, identifying and qualifying a new manufacturer to replace our current manufacturer could take 6 to 12 months.

At the end of January 2010, SST announced a relocation of its primary manufacturing facility, currently located in Shenzhen China, to Wuhan, Hubei China. The purpose of the relocation relates to an opportunity for SST to reduce its direct and overhead costs.

Based on information provided to it by SST as of the date of this filing, DCT anticipates the new manufacturing facility to be fully functional by April 2011 with minimal impact to the manufacturing process, we cannot provide assurance that production will not be negatively impacted. In the event that there is a delay in the relocation of the manufacturing facility our business operations could be materially adversely affected.

We depend on a limited number of suppliers to provide the components and raw materials necessary to manufacture our products; any interruption in the availability of these components and raw materials used in our product could reduce our revenues.

Although many alternative suppliers exist, we rely on a single or limited number of suppliers for many of the significant components and raw materials required to manufacture our document/image-capture products. This reliance leads to a number of significant risks, including:

- Unavailability of materials and interruptions in delivery of components and raw materials from our suppliers;
 - Manufacturing delays caused by such unavailability or interruptions in delivery; and

- Fluctuations in the quality and the price of components and raw materials.

We do not have any long-term or exclusive purchase commitments with any of our suppliers. Failure to maintain existing relationships with our current suppliers, or failure to establish new supplier relationships in the future, could negatively affect our ability to obtain necessary components and raw materials in a timely manner. If we are unable to obtain ample supply of materials from our existing suppliers or alternative supply sources, we may be unable to satisfy our customers' orders, which could reduce our revenues and adversely affect relationships with our customers.

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Our executive officers and key personnel are critical to our business and the loss of their services could adversely affect our business.

Our success depends to a significant degree upon the continuing contributions of our key executive officers and managers. Although we have employment agreements with most of these individuals, we cannot guarantee that we can retain these individuals. In addition, we have not obtained “key man” life insurance on the lives of any of the members of our management team.

The authorization and issuance of “blank check” preferred stock could have an anti-takeover effect detrimental to the interests of our stockholders.

Our certificate of incorporation allows the Board of Directors to issue preferred stock with rights and preferences set by our board without further stockholder approval. Under particular circumstances, the issuance of these “blank check preferred” shares could have an anti-takeover effect. For example, in the event of a hostile takeover attempt, it may be possible for management and the board to impede the attempt by issuing blank check preferred shares, thereby diluting or impairing the voting power of the other outstanding shares of common stock and increasing the potential costs to acquire control of our Company. Our Board of Directors has the right to issue blank check preferred shares without first offering them to holders of our common stock, as the holders of our common stock have no preemptive rights.

Our results of operations could vary as a result of the methods, estimates, and judgments that we use in applying our accounting policies.

The methods, estimates, and judgments that we use in applying our accounting policies have a significant impact on our results of operations (see “Critical Accounting Estimates” in Part II, Item 7 of this Form 10-K). Such methods, estimates, and judgments are, by their nature, subject to substantial risks, uncertainties, and assumptions, and factors may arise over time that lead us to change our methods, estimates, and judgments. Changes in those methods, estimates, and judgments could significantly affect our results of operations.

Risks Related To Our Intellectual Property and Technology

Unauthorized use of our intellectual property and proprietary technology could adversely affect our business and results of operations.

Our success and competitive position depend in large part on our ability to obtain and maintain intellectual property rights to protect our products. We currently, and may in the future, rely on a combination of patents, copyrights, trademarks, service marks, trade secrets, confidentiality provisions and licensing arrangements to establish and protect our intellectual property and proprietary rights. Unauthorized parties may attempt to copy aspects of our products or obtain, license, sell or otherwise use information that we regard as proprietary. Policing unauthorized use of our products is difficult, and we may not be able to protect our technology from unauthorized use.

Additionally, our competitors may independently develop technologies that are substantially the same or superior to ours without infringing our rights. In these cases, we would be unable to prevent our competitors from selling or licensing these similar or superior technologies. Further, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States.

Third parties have claimed and may claim in the future that we or our customers are infringing, or contributing to the infringement of, their intellectual property. We could be exposed to significant litigation or licensing expenses or be prevented from selling our products if such claims are successful.

We may be unaware of intellectual property rights of others that may cover some of our technologies and products. If it appears necessary or desirable, we may seek licenses for these intellectual property rights. However, we may not be able to obtain licenses from some or all claimants or the terms of any offered licenses may not be acceptable to us, and we may not be able to resolve disputes without litigation. Any litigation regarding intellectual property could be costly and time-consuming and could divert the attention of our management and key personnel from our business operations.

In the event of a claim of intellectual property infringement, we may be required to enter into costly royalty or license agreements. Third parties claiming intellectual property infringement may be able to obtain injunctive or other equitable relief that could effectively block our ability to develop and sell our products.

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Risks Relating To Our Common Stock

The stock market in general has experienced volatility that often has been unrelated to the operating performance of listed companies. These broad fluctuations may be the result of unscrupulous practices that may adversely affect the price of our stock, regardless of our operating performance.

Shareholders should be aware that, according to SEC Release No. 34-29093 dated April 17, 1991, the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include (1) control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer; (2) manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases; (3) boiler room practices involving high-pressure sales tactics and unrealistic price projections by inexperienced sales persons; (4) excessive and undisclosed bid-ask differential and markups by selling broker-dealers; and (5) the wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the resulting inevitable collapse of those prices and with consequent investor losses. The occurrence of these patterns or practices could increase the volatility of our share price.

The limited prior public market and trading market may cause possible volatility in our stock price.

To date, there has only been a limited public market for our securities and there can be no assurance that we can attain an active trading market for our securities. Our common stock trades on the OTC Bulletin Board ("OTCBB"), which is an unorganized, inter-dealer, over-the-counter market that provides significantly less liquidity than the national securities exchanges.

Quotes for securities quoted on the OTCBB are not listed in the financial sections of newspapers as are those for the national securities exchanges. Moreover, in recent years, the overall market for securities has experienced extreme price and volume fluctuations that have particularly affected the market prices of many smaller companies. The trading price of our common stock is expected to be subject to significant fluctuations which are affected by, but not limited to, the following:

- Quarterly variations in operating results and achievement of key business metrics;
 - Changes in earnings estimates by securities analysts, if any;
- Any differences between reported results and securities analysts' published or unpublished expectations;
 - Announcements of new products by us or our competitors;
- Market reaction to any acquisitions, joint ventures or strategic investments announced by us or our competitors;
 - Demand for our products;
- Shares sold pursuant to Rule 144 or upon exercise of warrants and options or conversion of Series B Convertible Preferred Stock; and
 - General economic or stock market conditions unrelated to our operating performance.

These fluctuations, as well as general economic and market conditions, may have a material or adverse effect on the market price of our common stock.

The OTCBB is a quotation system, not an issuer listing service, market or exchange. Therefore, buying and selling stock on the OTCBB is not as efficient as buying and selling stock through an exchange. As a result, it may be difficult for you to sell your common stock or you may not be able to sell your common stock for an optimum trading price.

The OTCBB executes trades and quotations using a manual process and cannot guarantee the market information for securities. In some instances, quote information, or even firm quotes, may not be available. The OTCBB's manual execution process may delay order processing and as a result, a limit order may fail to execute or a market order may

execute at a significantly different price due to intervening price fluctuations. Trade execution, execution reporting and legal trade confirmation delivery may be delayed significantly. Consequently, one may not be able to sell shares of our common stock at the optimum trading prices.

OTCBB securities are frequent targets of fraud or market manipulation not only because of their generally low price, but also because the OTCBB reporting requirements for these securities are less stringent than for listed or Nasdaq traded securities, and no exchange requirements are imposed. Dealers may dominate the market and set prices that are not based on competitive forces. Individuals or groups may create fraudulent markets and control the sudden, sharp increase of price and trading volume and the equally sudden collapse of the market price for shares of our common stock.

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When fewer shares of a security are being traded on the OTCBB, the security's market price may become increasingly volatile and price movement may outpace the ability to deliver accurate quote information. Due to lower trading volumes of our common stock, there may be a lower likelihood that one's orders for our common stock will be executed, and current prices may differ significantly from the price one was quoted by the OTCBB at the time of one's order entry.

Orders for OTCBB securities may be canceled or edited like orders for other securities. All requests to change or cancel an order must be submitted to, received and processed by the OTCBB. As mentioned earlier in this document, the OTCBB executes trades using a manual process, which could cause delays in order processing and reporting, and could hamper one's ability to cancel or edit one's order. Consequently, selling shares of our common stock at the optimum trading prices may be impossible.

The dealer's spread (the difference between the bid and ask prices) may be large and may result in substantial losses to the seller of our common stock on the OTCBB if the stock must be sold immediately. Further, purchasers of our common stock may incur an immediate "paper" loss due to the price spread. Moreover, dealers may not have a bid price for our common stock on the OTCBB. Due to the foregoing factors, demand for our common stock on the OTCBB may be decreased or eliminated.

Our common stock is considered a "penny stock." The application of the "penny stock" rules to our common stock could limit the trading and liquidity of the common stock, adversely affect the market price of our common stock and increase your transaction costs to sell those shares.

The Commission has adopted regulations which generally define a "penny stock" to be any equity security that has a market price (as defined) of less than \$5.00 per share or an exercise price of less than \$5.00 per share, subject to certain exceptions. As a result, our shares of common stock are subject to rules that impose additional sales practice requirements on broker-dealers who sell such securities to persons other than established clients and "accredited investors."

For transactions governed by these rules, the broker-dealer must make a special suitability determination for the purchase of such securities, must obtain the purchaser's written consent to the transaction, and must deliver to the purchaser a SEC-mandated, penny stock risk disclosure document, all prior to the purchase. The broker-dealer must also disclose the commission payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Consequently, the "penny stock" rules may restrict the ability of broker-dealers to sell our shares of common stock and may affect the ability of investors to sell such shares of common stock in the secondary market and may affect the price at which investors can sell such shares.

Investors should be aware that the market for penny stocks has suffered in recent years from patterns of fraud and abuse, according to the Commission. Such patterns include:

- Control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer;
- Manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases;
- "Boiler room" practices involving high pressure sales tactics and unrealistic price projections by inexperienced sales persons;
 - Excessive and undisclosed bid-ask differentials and markups by selling broker-dealers; and
- The wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the inevitable collapse of those prices with consequent investor losses.

Our management is aware of the abuses that have occurred historically in the penny stock market.

Additional authorized shares of our common stock and preferred stock available for issuance may result in substantial dilution to our shareholders.

We are authorized to issue 50,000,000 shares of our common stock. As of March 15, 2010, there were 19,406,270 shares of common stock issued and outstanding. However, the total number of shares of our common stock issued and outstanding does not include shares reserved in anticipation of the exercise of options or warrants. As of March 1, 2009, we had the following common shares reserved for future issuance:

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Stock options outstanding	11,355,498
Warrants outstanding	2,002,027
Total	13,357,525

The numbers above do not include 460,667 shares that are reserved pursuant to our 2009 Stock Option Plan for future grant. To the extent that options or warrants are exercised, the holders of our common stock will experience further dilution. In addition, in the event that any future financing should be in the form of, be convertible into or exchangeable for, equity securities, and upon the exercise of options and warrants, investors may experience additional dilution.

While we have no present plans to issue additional shares of preferred stock in the future, our board of directors has the authority (as previously discussed), without stockholder approval, to create and issue one or more series of such preferred stock and to determine the voting, dividend and other rights of holders of such preferred stock. The above table does not include any future issuance of preferred stock. The issuance of any of such series of preferred stock will cause further dilution to holders of our common stock.

Future sales of our common stock could put downward selling pressure on our common stock, and adversely affect the per share price. There is a risk that this downward pressure may make it impossible for an investor to sell shares of common stock at any reasonable price, if at all.

From time to time, certain of our stockholders may be eligible to sell all or some of their shares of common stock by means of ordinary brokerage transactions in the open market pursuant to Rule 144, promulgated under the Securities Act of 1933 (Securities Act), subject to certain limitations. In general, Rule 144 permits the unlimited sale of securities by our stockholders that are non-affiliates that have satisfied a six month holding period, and affiliates of our Company may sell within any three month period a number of securities that does not exceed 1% of our then outstanding shares of common stock. Any substantial sale of our common stock pursuant to Rule 144 or pursuant to any resale prospectus may have material adverse effect on the market price of our securities.

Limitations on director and officer liability and our indemnification of officers and directors may discourage shareholders from bringing suit against a director.

Our certificate of incorporation and bylaws provide, with certain exceptions as permitted by governing Delaware law, that a director or officer shall not be personally liable to us or our shareholders for breach of fiduciary duty as a director, except for acts or omissions which involve intentional misconduct, fraud or knowing violation of law, or unlawful payments of dividends. These provisions may discourage shareholders from bringing suit against a director for breach of fiduciary duty and may reduce the likelihood of derivative litigation brought by shareholders on our behalf against a director. In addition, our certificate of incorporation and bylaws provide for mandatory indemnification of directors and officers to the fullest extent permitted by Delaware law.

ITEM 2. PROPERTIES

The following table lists details of our properties at December 31, 2009:

Location	Lease expiration	Total Square Footage	Primary Usage
San Jose, CA	June 2010	5,500	Corporate headquarters and product development
Santa Clara, CA	June 2010	6,000	Inventory management and distribution
Arnhem, Netherlands	Month to month	270	Field service and sales office
Schiphol, Netherlands	Month to month	1,400	Inventory management and distribution

We believe our properties are adequate for our current needs and will be sufficient to serve the needs of our operations for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

We are subject to various legal proceedings from time to time in the ordinary course of business, none of which is currently required to be disclosed under this Item 3.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock is listed on the OTC Bulletin Board (“OTCBB”). Effective January 11, 2008, in connection with the name change to “Document Capture Technologies, Inc.” from “Sysview Technology, Inc.,” our stock symbol changed to “DCMT” from “SYVT.” The following table sets forth the range of high and low sales prices for the Company’s common stock for the periods indicated:

	High	Low
Fiscal 2009:		
1st Quarter	\$ 0.60	\$ 0.30
2nd Quarter	0.68	0.30
3rd Quarter	0.64	0.33
4th Quarter	0.45	0.14
Fiscal 2008:		
1st Quarter	\$ 0.90	\$ 0.55
2nd Quarter	0.84	0.35
3rd Quarter	0.75	0.30
4th Quarter	0.67	0.25

Such prices represent quotations between dealers, without dealer markup, markdown or commissions, and may not represent actual transactions.

Record Holders

As of March 15, 2010, there were 19,406,270 shares of common stock issued and outstanding, held by approximately 375 holders of record as indicated on the records of DCT’s transfer agent.

Dividends

Common Stock. The Company has not declared or paid dividends on its common stock to date and intends to retain any earnings for use in the business for the foreseeable future.

Preferred Stock. Through the maturity date of March 15, 2008, holders of our Series A 5% cumulative convertible preferred stock (“Series A Stock”) were entitled to receive dividends at a rate of 5% per year. Dividends were payable in cash, by accretion of the Series A Stock stated value or in shares of common stock. Subject to certain terms and conditions, the decision whether to accrete dividends to the stated value of the Series A Stock or to pay for dividends in cash or in shares of common stock, was at the Company’s discretion. The Company chose to pay all Series A Stock dividends by accreting the stated value of the Series A Stock, which converted to shares of our common stock at maturity.

Equity Compensation Plan Information

The following table sets forth certain information concerning shares of common stock authorized for issuance under the Company's existing equity compensation plans as of December 31, 2009:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	6,739,333	\$ 0.42	460,667
Equity compensation plans not approved by security holders	4,616,165	0.17	—
Total	11,355,498	\$ 0.32	460,667

2002 Amended and Restated Stock Option Plan

At our stockholders' annual meeting on June 23, 2006, our stockholders approved the adoption of the 2002 Amended and Restated Stock Option Plan ("2002 Plan"). Currently, the plan is administered by our Board of Directors. The 2002 Plan generally provides for the grant of either qualified or nonqualified stock options to officers, employees, directors and consultants at not less than 85% of the fair market value of our common stock as of the grant date.

The 2002 Plan provides that vested options may generally be exercised for three months after termination of employment and for 12 months after termination of employment as a result of death or disability. If the Company liquidates, optionees will be notified at least 30 days prior to the proposed dissolution or liquidation to give optionees time to exercise any vested options. To the extent not previously exercised, all options will terminate immediately prior to the consummation of such proposed action. However, the plan administrator may, under its sole discretion, permit exercise of any options prior to their termination, even if such options were not otherwise exercisable.

In the event of our change in control (including our merger with or into another corporation, or sale of substantially all our assets), the 2002 Plan provides that each outstanding option will fully vest and become exercisable. The maximum number of options that can be granted under the 2002 Plan is 3,200,000. As of December 31, 2009, there were no options available for future grant under the 2002 Plan.

2006 Stock Option Plan

At our stockholders' annual meeting on June 23, 2006, our stockholders approved the adoption of the 2006 Stock Option Plan ("2006 Plan"). Currently the plan is administered by our Board of Directors. The 2006 Plan generally provides for the grant of either qualified or nonqualified stock options to officers, employees, directors and consultants at not less than 85% of the fair market value of our common stock as of the grant date.

The 2006 Plan provides that vested options may generally be exercised for three months after termination of employment and for 12 months after termination of employment as a result of death or disability. If the Company liquidates, optionees will be notified at least 30 days prior to the proposed dissolution or liquidation to give optionees time to exercise any vested options. To the extent not previously exercised, all options will terminate immediately prior to the consummation of such proposed action. However, the plan administrator may, under its sole discretion, permit exercise of any options prior to their termination, even if such options were not otherwise exercisable. In the event of our change in control (including our merger with or into another corporation, or sale of substantially all our assets), the 2006 Plan provides that each outstanding option will fully vest and become exercisable. At the Company's annual meeting on October 3, 2008, the Company's shareholders agreed to increase the maximum number of options that can be granted under the 2006 Plan from 1,500,000 to 2,500,000. As of December 31, 2009, there were no options available for future grant under the 2006 Plan.

2009 Stock Option Plan

At our stockholders' annual meeting on September 14, 2009, our stockholders approved the adoption of the 2009 Stock Option Plan ("2009 Plan"). Currently the plan is administered by our Board of Directors. The 2009 Plan generally provides for the grant of either qualified or nonqualified stock options to officers, employees, directors and consultants at not less than 85% of the fair market value of our common stock as of the grant date.

The 2009 Plan provides that vested options may generally be exercised for three months after termination of employment and for 12 months after termination of employment as a result of death or disability. If the Company liquidates, optionees will be notified at least 30 days prior to the proposed dissolution or liquidation to give optionees time to exercise any vested options. To the extent not previously exercised, all options will terminate immediately prior to the consummation of such proposed action. However, the plan administrator may, under its sole discretion, permit exercise of any options prior to their termination, even if such options were not otherwise exercisable. In the event of our change in control (including our merger with or into another corporation, or sale of substantially all our assets), the 2009 Plan provides that each outstanding option will fully vest and become exercisable. As of December 31, 2009, there were 460,667 options available for future grant under the 2009 Plan.

Recent Sales of Unregistered Securities

During the year ended December 31, 2009, we did not issue any securities that were not registered under the Securities Act of 1933, as amended (the "Securities Act") except as disclosed in previous SEC filings.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

There were no repurchases of equity securities by the issuer or affiliated purchasers during the fourth quarter of the year ended December 31, 2009.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with other sections of this Form 10-K including Part 1, "Item 1: Business" and Part II, "Item 8: Financial Statements." Various sections of management's discussion and analysis ("MD&A") contain statements that are forward-looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially due to factors discussed in this report, as well as factors not within our control. We undertake no duty to update any forward-looking statement to conform the statement to actual results or changes in our expectations.

Our MD&A is provided as a supplement to our audited financial statements to help provide an understanding of our financial condition, changes in financial condition and results of operations. The MD&A section is organized as follows:

- **Overview.** This section provides a general description of the Company's business, as well as recent developments that we believe are important in understanding our results of operations as well as anticipating future trends in our operations.
- **Critical Accounting Policies.** This section provides an analysis of the significant estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses, and the related disclosure of contingent assets and liabilities.
- **Results of Operations.** This section provides an analysis of our results of operations for the year ended December 31, 2009 ("Fiscal 2009") compared to the year ended December 31, 2008 ("Fiscal 2008"). A brief description of certain aspects, transactions and events is provided, including related-party transactions that impact the comparability of the results being analyzed.
- **Liquidity and Capital Resources.** This section provides an analysis of our financial condition as of December 31, 2009 and our cash flows for Fiscal 2009 compared to Fiscal 2008.
- **Contractual Obligations, Off-Balance-Sheet Arrangements, and Trends.** As of December 31, 2009, an overview of (i) contractual obligations and contingent liabilities and commitments, including an expected payment schedule, (ii) an explanation of off-balance-sheet arrangements, and (iii) known trends.

Overview

We are in the business of designing, developing and delivering imaging technology solutions. Our technology is protected under multiple patents. We focus our research and development toward new deliverable and marketable technologies related to document digitization and utilization. We sell our products to customers throughout the world, including the United States, Canada, Europe, 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. We are actively shipping five groups of image-capture products. We have expanded our document/image-capture product offerings, and will continue to expand our product offerings in the future in response to the increased market demand for faster, easier-to-use products and increased security to meet the growing need for information protection, including identity and financial transaction protection.

In 2008, DCT focused on re-aligning its operations toward its core revenue-generating competencies in an effort to cut costs and maximize profits. In 2009 DCT identified and pursued key significant market opportunities available to the Company. We believe that the result of these corporate initiatives has uniquely positioned DCT for growth in 2010

and beyond.

DCT introduced three new products during Fiscal 2009. New products include new technology for added functionality as well as improved existing functionality. Additionally, our new products already have an existing market, and we have already begun delivery or received orders for all three new products.

Critical Accounting Policies

The methods, estimates and judgments we use in applying our accounting policies have a significant impact on the results we report in our financial statements, which we discuss under the heading “Results of Operations” following this section of our MD&A. Some of our accounting policies require us to make difficult and subjective judgments, often resulting from the need to make estimates on matters that are inherently uncertain.

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We believe the following critical accounting policies reflect our more significant estimates and assumptions used in the preparation of our consolidated financial statements:

Revenue Recognition

Revenues consist of sales of merchandise, including optical document/image-capturing devices, modules of optical document/image-capturing devices, optical image chips and other optoelectronic products. Revenue is recognized when the product is shipped or delivered and the risks, rewards and title of ownership have transferred to the customer. We recognize some shipping and handling fees as revenue, and the related expenses as a component of cost of sales. All internal handling charges are included with selling and marketing expense. Historically, sales returns have not been significant. As such, we do not record a reduction to revenue for estimated product returns in the same period that the related revenue is recorded.

Sales Incentives

In certain instances, we offer sales incentives whereby we give customers additional product for certain volume-related purchases. We record the cost of the product-related sales incentives as a cost of sales during the period the incentive is earned.

Inventory and Warranty Reserves

We establish inventory reserves for estimated obsolescence, unmarketable, or slow-moving inventory in an amount equal to the difference between the cost of inventory and its estimated realizable value based upon assumptions about future demand and market conditions. If actual demand and market conditions are less favorable than those projected by management, additional inventory reserves could be required. At December 31, 2008, we had a \$20,000 inventory reserve for specifically identified slow-moving inventory. We sold such inventory during Fiscal 2009. No additional obsolete, unmarketable, or slow-moving inventory was identified at December 31, 2009.

Historically, we have purchase the majority of our finished scanner imaging products from Shenzhen Syscan Technology ("SST"), a wholly-owned subsidiary of Syscan Technology Holdings Limited ("STH"). SST was DCT's majority shareholder until July 2008. As of December 31, 2009, SST held less than 20% of DCT's outstanding common stock. SST warrants the products it manufactures for us against defects in material and workmanship for a period of 18 months after the completion of manufacture. After such 18 month period, SST provides product repair services for us at its customary hourly repair rate plus the cost of any parts, components or items necessary to repair the products. As a result of the product warranty provided by SST, DCT does not record a product warranty reserve.

Related-Party Transactions

We have significant related-party transactions and agreements, which we believe have been accounted for at fair value. We utilized our best estimate of the value of these transactions and agreements. Had alternative assumptions been used, the values obtained may have been different.

Related-Party Purchases

As discussed above, we purchase the majority of our finished scanner imaging products from SST. Purchases from SST totaled \$6,546,000 and \$6,816,000 for the years ended December 31, 2009 and 2008, respectively. All purchases from SST were carried out in the normal course of business. As a result of these purchases, DCT was liable to SST for \$341,000 and \$393,000 at December 31, 2009 and 2008, respectively.

Related-Party Net Sales

During the year ended December 31, 2009 and 2008, DCT recorded net sales totaling \$72,000 and \$57,000, respectively, for finished scanners sold to SST. The related cost of goods sold was \$39,000 and \$41,000 for the years ended December 31, 2009 and 2008, respectively. All sales to SST contained similar terms and conditions as for other transactions of this nature entered into by DCT.

Revised Consulting Agreement

In August 2009, DCT amended an existing consulting contract, originally entered in July 2008, with one of its shareholders who owns more than 5% of DCT's outstanding stock. The amendment called for DCT to make a one-time cash payment of \$30,000, and for the consultant to return to DCT 275,000 non-qualified stock options, at an exercise price of \$0.30 per share, to purchase shares of DCT common stock. The stock options were originally granted to the shareholder in July 2008. All other terms of the original contract remain in effect.

Legal Services Agreement

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

Pursuant to the Agreement, Mr. Samuels is paid \$4,000 per month, and for the year ended December 31, 2009, was paid an aggregate of \$14,000. The Agreement may be cancelled by either party with 30 days prior written notice.

Impairment of Long-Lived Assets

We evaluate our long-lived assets for impairment annually or more frequently if we believe indicators of impairment exist. Significant management judgment is required during the evaluation, which includes forecasts of future operating results. The estimates we have used are consistent with the plans and estimates that we use to manage our business. It is possible, however, that the plans and estimates used may be incorrect. If our actual results, or the plans and estimates used in future impairment analyses, are lower than the original estimates used to assess the recoverability of these assets, we could incur additional impairment charges. We had no such asset impairments during Fiscal 2009 or Fiscal 2008.

Income Taxes

We utilize the liability method of accounting for income taxes. Deferred income tax assets and liabilities are calculated as the difference between the financial statements and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income.

We record a valuation allowance to reduce our deferred tax assets to the amount that we believe is more likely than not to be realized. In assessing the need for a valuation allowance, we consider all positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial performance.

The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws themselves are subject to change as a result of changes in fiscal policy, changes in legislation, evolution of regulations and court rulings. Therefore, the actual income taxes may be materially different from our estimates. As a result of our analysis, we concluded that a full valuation allowance against our net deferred tax assets is appropriate at December 31, 2009 and 2008.

Contingencies

From time to time, we are involved in disputes, litigation and other legal proceedings. We record a charge equal to at least the minimum estimated liability for a loss contingency when both of the following conditions are met: (i) information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements, and (ii) the range of loss can be reasonably estimated. However, the actual liability in any such litigation may be materially different from our estimates, which could result in the need to record additional costs. Currently, we have no outstanding legal

proceedings or claims that require a loss contingency.

Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity

We account for our Series A 5% Cumulative Convertible Preferred Stock ("Series A Stock"), which matured March 15, 2008, and our Series B Convertible Preferred Stock ("Series B Stock"), which matured August 7, 2009, pursuant to the Derivative Instruments and Hedging Topic of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("Codification"). Accordingly, the embedded conversion feature of our Series A Stock and Series B Stock were accounted for as derivative instruments and were bifurcated from the host contract.

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The fair value of these derivative instruments, as determined by applying the Black-Scholes valuation model, was adjusted at each reporting period until the maturity of the host contract. The Black-Scholes valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The Black-Scholes valuation model requires the input of highly subjective assumptions, including the expected stock price volatility. Our derivative instruments have characteristics significantly different from traded options, and the input assumptions used in the model can materially affect the fair value estimate.

Stock-Based Compensation Expense

DCT's has incentive plans that permit us to grant incentive stock options and non-qualified stock options to employees, directors and consultants. All stock options are valued using a Black-Scholes option pricing model. The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by our stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. We use the historical volatility for our common stock as the expected volatility assumption required in the Black-Scholes model, which could be significantly different than actual volatility. The expected life of the awards is based on historical and other economic data trended into the future. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our awards. The dividend yield assumption is based on our history and expectation of dividend payouts. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Stock-based compensation expense recognized in our financial statements is based on awards that are ultimately expected to vest. We evaluate the assumptions used to value our awards on a quarterly basis. If factors change and we employ different assumptions, stock-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. Future stock-based compensation expense and unearned stock-based compensation will increase to the extent that we grant additional equity awards to employees.

Fair Value of Financial Instruments

We account for certain liabilities pursuant to the Fair Value Topic of the Codification, which defines three levels of inputs that may be used to measure fair value:

Level 1. Quoted prices in active markets for identical assets or liabilities. DCT had no Level 1 assets or liabilities during Fiscal 2009 or Fiscal 2008.

Level 2. Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets with insufficient volume or infrequent transactions (less active markets), or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data for substantially the full term of the assets or liabilities. DCT had no Level 2 assets or liabilities during Fiscal 2009 or Fiscal 2008.

Level 3. Unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of assets or liabilities. The determination of fair value for Level 3 instruments requires the most management judgment and subjectivity. DCT had no Level 3 assets during Fiscal 2009 or Fiscal 2008. Level 3 liabilities include (i) warrant and (ii) derivative contracts liabilities. DCT estimates the fair value of Level 3 liabilities using the Black-Scholes valuation model. During Fiscal 2009, DCT's Level 3 liabilities either matured or converted to equity. As such, DCT had no Level 3 liabilities at December 31, 2009. The adjustment to the fair value of our Level 3 liabilities was not significant in Fiscal 2008.

Results of Operations

The following table summarizes certain aspects of our results of operations for Fiscal 2009 compared to Fiscal 2008 (in thousands):

	Fiscal 2009	Fiscal 2008	\$ Change	% Change
Net sales	\$ 11,529	\$ 11,643	\$ (114)	(1)%
Cost of sales	6,936	7,696	(760)	(10)