

DOCUMENT CAPTURE TECHNOLOGIES, INC.  
Form 10-K  
April 15, 2009

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, 2008

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)

59-3134518  
(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 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 (8,870,256 shares) was approximately \$3,902,913, based on the average closing bid and ask price of \$0.44 for such common equity as of June 30, 2008.

As of March 31, 2009, there were outstanding 18,443,770 shares of the issuer’s Common Stock, par value \$0.001.

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DOCUMENTS INCORPORATED BY REFERENCE

None

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## 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, 2008

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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 imaging 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-imaging 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 established 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 ideally suited for laptop or desktop computer users who need a small lightweight device to scan or fax 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:

- Document and information management;
  - Identification card scanners;
  - Passport security scanners;
  - Bank note and check verification;
  - 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 VISIONEER, PENTAX, BROTHER, DYMO-CARDSCAN, AMBIR TECHNOLOGY, DIGIMARC, BANKSERV and OMRON. 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 is (in thousands):

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Year Ended	Net Revenue
December 31, 2008	\$ 11,643
December 31, 2007	15,023
December 31, 2006	12,469

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

#### DocketPORT

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

- True duplex scanning capability (several models scan both sides of a two-sided document at once);
  - High-speed Universal Serial Bus (“USB”) powered;
  - 600 dots per inch (“DPI”) optical resolution;
  - Minimal power consumption;
  - 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
- Scans 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 using a fixed 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;
- 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, 2008. These competitors, in general, are under contract to pay us a royalty fee for the use of our intellectual property. To maintain our competitive advantage we maintain a high level of investment in research and development and focus on factory efficiency allowing 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:

- 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;
- Broad distribution channels; and
- Product quality and performance.



## 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”), the parent company of our former majority stockholder. See Part III, “Item 13: Certain Relationships and Related Transactions, and Director Independence.”

We purposely limit the manufacturing of our product to SST as this gives us better control over both the quality of our product and the price we pay for the 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 12 months to establish a new subcontract manufacturer. To mitigate this exposure, we provide most of the critical components and tooling required to manufacture our proprietary products.

**Raw Materials.** SST purchases the raw materials, parts and components with the exception of the critical components as 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. We have some controller chips that are sole-sourced, as they are specialized devices that can effectively control the cost of our product. We do not have any long-term or exclusive purchase commitments with any of our suppliers.

Where possible, we work with secondary suppliers to qualify additional sources of supply. To reduce the risk associated with using a sole supplier, we attempt to maintain strategic inventories of these sole-sourced components. 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 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 82% and 72% during the years ended December 31, 2008 and 2007, 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. Our largest customer rankings and their respective contributions to our net sales have varied and will likely continue to vary from period to period. We typically sell products pursuant to purchase orders that customers can generally defer without incurring a significant penalty. 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 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.

## 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.

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## Compliance with Environmental, Health and Safety Regulations

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. Additionally, we are currently completing REACH (Registration, Evaluation, Authorization and Restriction of Chemical substances) certification.

## Research and Development

We have historically devoted a significant portion of our financial resources to research and development programs for both our current products and our future products, and we expect to continue to allocate significant resources to these efforts. Until November 2007, the majority of our research and development efforts were focused on our high definition (“HD”) display technologies. During November 2007, we terminated our HD display research and development efforts. No HD-related research and development expenses were incurred during the year ended December 31, 2008. By terminating our HD display research and development efforts, we can focus our future research and development efforts and activities and financial resources on our core revenue generating document/image-capture products.

Our research and development expenses were \$712,000 and \$2,439,000 for the years ended December 31, 2008 and 2007, 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 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 customer demands.

## Backlog

We do not believe that backlog as of any particular date is meaningful as our sales are made primarily pursuant to standard purchase orders for delivery of products. Additionally, all of our customer orders are cancelable.

## Seasonal Trends

Our sales generally have followed a 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, 2008, we employed 15 people on a full-time basis, 12 employees were located in the United States, two were located in China and one was located in Europe. Of the total, four were in product research and development and 11 were in sales 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](http://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 1-408-436-9888 ext. 207.

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](http://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 82% and 72% during the years ended December 31, 2008 and 2007, 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 \$422,000 and \$1,913,000 for the years December 31, 2008 and 2007, respectively. Our accumulated deficit as of December 31, 2008 was \$32,831,000. We cannot provide assurance that we can achieve profitability in the future.

We 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.

We depend on a limited number of suppliers to provide the components and raw materials necessary to manufacture our products and 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.

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.

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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.

We are subject to the requirements of Section 404 of the Sarbanes-Oxley Act. If we are unable to timely comply with Section 404 or if the costs related to compliance are significant, our profitability, stock price and results of operations and financial condition could be materially adversely affected.

We are required to comply with the provisions of Section 404 of the Sarbanes-Oxley Act of 2002, which require us to maintain an ongoing evaluation and integration of the internal controls of our business. We were required to document and test our internal controls and certify that we are responsible for maintaining an adequate system of internal control procedures for the year ended December 31, 2008. In subsequent years, our independent registered public accounting firm will be required to opine on those internal controls and management’s assessment of those controls. In the process, we may identify areas requiring improvement, and we may have to design enhanced processes and controls to address issues identified through this review.

We cannot be certain that we will be able to successfully complete the certification and attestation requirements of Section 404 or that our auditors will not have to report a material weakness in connection with the presentation of our financial statements. If we fail to comply with the requirements of Section 404 or if our auditors report such material weakness, the accuracy and timeliness of the filing of our annual report may be materially adversely affected and could cause investors to lose confidence in our reported financial information, which could have a negative affect on the trading price of our common stock. In addition, a material weakness in the effectiveness of our internal controls over financial reporting could result in an increased chance of fraud and the loss of customers, reduce our ability to obtain financing and require additional expenditures to comply with these requirements, each of which could have a material adverse effect on our business, results of operations and financial condition.

Further, we believe that the out-of-pocket costs, the diversion of management’s attention from running the day-to-day operations and operational changes caused by the need to comply with the requirements of Section 404 of the Sarbanes-Oxley Act could be significant. If the time and costs associated with such compliance exceed our current expectations, our results of operations could be adversely affected.

#### 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 are infringing their intellectual property, and we could be exposed to significant litigation or licensing expenses or be prevented from selling our products if such claims are successful. From time to time, we are subject to claims that we or our customers may be infringing or contributing to the infringement of the intellectual property rights of others.

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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.

#### 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