

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

FORM 10-K

(Mark one)

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

For the fiscal year ended: September 30, 1997

OR

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

For the transition period from ____ to ____.

Commission file number: 0-17972

DIGI INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

Delaware

41-1532464

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

11001 Bren Road East
Minnetonka, Minnesota 55343

(Address of principal executive offices) (Zip Code)

(612) 912-3444

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common stock, \$.01 par value

(Title of each class)

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, and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. []

The aggregate market value of voting stock held by nonaffiliates of the Registrant, based on a closing price of \$20.125 per share as reported on the National Association of Securities Dealers Automated Quotation System-National Market System on December 12, 1997 was \$236,783,746.

Shares of common stock outstanding as of December 12, 1997: 13,485,942

DOCUMENTS INCORPORATED BY REFERENCE

The following table shows, except as otherwise noted, the location of information required in this Form 10-K, in the Registrant's Annual Report to Stockholders for the year ended September 30, 1997 and Proxy Statement for the Registrant's Annual Meeting of Stockholders scheduled for January 28, 1998, a definitive copy of which was filed on December 26, 1997. All such information set forth below under the heading "Reference" is incorporated herein by reference.

PART I	ITEM IN FORM 10-K	REFERENCE
-----	-----	-----
Item 1.	Business	Business, pages 4 through 8, this document; Note 1, Notes to Consolidated Financial Statements Annual Report to Stockholders
Item 2.	Properties	Properties, pages 8 and 9, this document
Item 3.	Legal Proceedings	Legal Proceedings, pages 9 and 10, this document
Item 4.	Submission of Matters to a Vote of Security Holders	Submission of Matters to a Vote of Security Holders, page 10, this document
PART II		

Item 5.	Market for Registrant's Common Equity and Related Stockholder Matters	Stock Listing; Dividend Policy, page 35, Annual Report to Stockholders
Item 6.	Selected Financial Data	Financial Highlights, and Selected Financial Information, page 2, Annual Report to Stockholders
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	Management's Discussion and Analysis of Financial Condition and Results of Operations, pages 16 through 20, Annual Report to Stockholders
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	Quantitative and Qualitative Disclosures About Market Risk, page 10, this document

Item 8.	Financial Statements and Supplementary Data	Annual Report to Stockholders, pages 21 through 33
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	Changes and Disagreements with Accountants on Accounting and Financial Disclosure, page 10, this document
PART III - - - - -	ITEM IN FORM 10-K - - - - -	REFERENCE - - - - -
Item 10.	Directors of the Registrant	Election of Directors, Proxy Statement
	Executive Officers of the Registrant	Executive Officers of the Registrant, pages 10 through 11, this document
	Compliance with Section 16(a) of the Exchange Act	Section 16(a) Beneficial Ownership Reporting Compliance, Proxy Statement
Item 11.	Executive Compensation	Executive Compensation; Election of Directors, Summary Compensation Table; Option Grants in Last Fiscal Year; Aggregated Option Exercises in the Last Fiscal Year and Year-end Option Values, Employment Contracts; Severance, Termination of Employment and Change-in-Control Arrangements; Performance Evaluation, Proxy Statement
Item 12.	Security Ownership of Certain Beneficial Owners and Management	Security Ownership of Principal Stockholders and Management, Proxy Statement
Item 13.	Certain Relationships and Related Transactions	Certain Relationships and Related Transactions, Proxy Statement
PART IV - - - - -		
Item 14.	Exhibits, Financial Statement Schedules and Reports on Form 10-K	Exhibits, Financial Statement Schedules and Reports on Form 10-K, pages 12 through 15, this document

PART I

ITEM 1. BUSINESS

Digi International Inc. (the "Company") was formed in 1985 as a Minnesota corporation and reorganized as a Delaware corporation in 1989. The Company is a leading ISO 9001- compliant provider of data communications hardware and software that delivers seamless connectivity solutions for multiuser environments, open systems, server-based remote access and LAN (Local Area Network) markets.

The two major product areas include: 1) communications interface cards for multiuser and remote access environments which constituted approximately 76% of net sales in fiscal 1997, and 2) "physical layer" and print server products that enhance the data communications capabilities of a LAN and which constituted 24% of net sales in fiscal 1997. Neither product area is date sensitive and will not require adaptation to comply with Year 2000 requirements.

Key differentiators of the Company's communications interface cards include: 1) its embedded high-performance operating system software (firmware), and 2) the device driver software component which is optimized to work with a variety of industry-standard operating systems and allows the operating system (OS) to communicate efficiently and reliably with peripheral devices.

The Company's communications interface cards provide asynchronous (transmitting single characters at a time) and synchronous (transmitting characters in a group) data transmissions for analog modems, ISDN (Integrated Services Digital Network) X.25, Frame Relay or T1/E1 connections.

The Company's communications interface card products provide connections for two primary markets:

1. The core multiport access products provide PC-host-to-terminal serial I/O (input/output) connections. These products facilitate data transmission for point-of-sale applications, on-line transaction processing, factory automation, and data collection and dissemination, among others. The onboard firmware allows the products to quickly, accurately and reliably transmit data, thereby eliminating the information bottlenecks that can result when multiple users or devices share one processing unit. These solutions primarily use multiuser, multitasking operating systems such as UNIX (and its variations), along with standard PC servers and the communications interface card.
2. Open systems, server-based remote access products. These communications interface cards address the need for high-performance, dial-in/dial-out connections which are necessary for wide area networking, including accessing the Internet. The Company's remote access products provide the communications ports which are needed to connect telecommuters, mobile workers and branch offices to corporate LANs, or branch offices to other branches, or to make the connections to the Internet. These solutions primarily

use open system operating systems such as Novell NetWare or Microsoft Windows NT RAS (and subsequent upgrades) along with standard PC servers and the communications interface card.

The Company entered the LAN market with its acquisition of MiLAN Technology Corporation in November 1993. The MiLAN Technology Division provides cost-effective and power-efficient Ethernet, Fast Ethernet and Token Ring networking connectivity products that are installed on a LAN to increase its productivity.

The Company's LAN products are recognized for their price/performance, reliability, robust features, and superior technical support.

The Company's MiLAN networking products include these primary groups:

1. The physical layer line of products that allow users to easily build and expand networks using single and multiport transceivers, converters, modular microhubs and modular repeaters, as well as the first comprehensive family of physical layer connectivity solutions for Fast Ethernet.
2. Print server products based on the FastPort line, which makes print sharing convenient and affordable. The FastPort line includes the industry's first multiprotocol network print server providing access to any printer on an Ethernet or Token Ring network without the inconvenience and expense of spooling through a workstation or server.

The Company works closely with customers, PC and server vendors, operating system companies and other marketing partners to continuously optimize Digi's WAN and LAN products to interoperate in open systems, industry-standard environments. This assures customers the ability to choose the most flexible, cost-effective solution to meet their individual needs.

The Company markets its products to a broad range of customers, including major domestic and international distributors, system integrators, VARs (Value Added Resellers) and OEMs (Original Equipment Manufacturer).

The Company's products are sold through a network of more than 201 distributors in the United States, Canada and 70 countries worldwide and through OEM (Original Equipment Manufacturer) contracts.

In July 1991, the Company opened a sales support office in Germany to increase sales support to the European distribution network. In October 1993, the Company opened a sales support office in Singapore to increase sales support for its products to the Pacific Rim distribution network. In 1996, the Company opened similar offices in Hong Kong, Sydney and Tokyo and in 1997, the Company opened sales offices in Paris and London to better serve its non-U.S. markets.

To serve its worldwide markets, the Company (i) offers products that, in the opinion of management, provide superior performance relative to current standards and application requirements, (ii) provides products that are compatible with a broad array of open system operating systems and industry-standard PC, server and workstation architectures, and (iii) provides, in the opinion of management, superior technical support, including frequent and timely product updates and ready access to the Company's support staff.

The computer industry is characterized by rapid technological advances and evolving industry standards. The market can be significantly affected by new product introductions and marketing activities of industry participants. The Company competes for customers on the basis of product performance in relation to compatibility, support, quality and reliability, product development capabilities, price and availability. Many of the Company's competitors and potential competitors have greater financial, technological, manufacturing, marketing and personnel resources than the Company. The Company believes that it is the market leader in the multiport access and open system, server-based remote access markets of the computer industry. With respect to the LAN market, the Company believes it commands less than a 5% market share.

The Company's manufacturing operations procure all parts and certain services involved in the production of products. The Company subcontracts most of its product manufacturing to outside firms that specialize in providing such services. The Company believes that this approach to manufacturing is beneficial because it permits the Company to reduce its fixed costs, maintain production flexibility and maximize its profit margins.

The Company's products are manufactured to its designs with standard and semi-custom components. Virtually all of these components are available from multiple vendors.

During fiscal years 1995, 1996 and 1997, the Company's research and development expenditures were \$14.8, \$21.3 and \$18.0 million, respectively.

Due to the rapidly changing technology in the computer industry, the Company believes that its success depends primarily upon the engineering, marketing, manufacturing and support skills of its personnel, rather than upon patent protection. Although the Company may seek patents where appropriate and has certain patent applications pending for proprietary technology, the Company's proprietary technology or products are generally not patented. The Company relies primarily on the copyright, trademark and trade secret laws to protect its proprietary rights in its products. The Company has established common law and registered trademark rights on a family of marks for a number of its products.

Through September 30, 1997, the Company purchased \$11.8 million in secured convertible notes from AetherWorks Corporation, a development stage company engaged in the development of wireless and dial-up remote access technology. The Company is obligated to purchase up to an additional \$2.0 million secured convertible notes from time to time at the request of AetherWorks, based on certain conditions. Secured convertible notes held by the Company were convertible at September 30, 1997 into 60% of AetherWorks' common stock, and the purchase of the \$2 million additional principal amount of secured notes would

increase the Company's ownership portion upon conversion to 62.7%, based on AetherWorks' present capitalization. On October 14, 1997, the Company entered into a revised note agreement with AetherWorks, that clarifies and limits the Company's financial commitment for the purchase of convertible notes to a maximum of \$13.8 million. The revised note agreement, however, also provides for payments, at the discretion of AetherWorks, on the outstanding convertible notes of up to \$7.2 million, in exchange for a reduction in the Company's potential ownership interest, upon conversion, to 19%. The revised note agreement, among other things, rescinded previous technology transfer and manufacturing agreements. Also in connection with the financing arrangement, the Company has also guaranteed \$3.1 million of lease obligations. In addition, the Company has leased to AetherWorks \$1.3 million of computer equipment under a three year direct financing lease agreement. The Company has reported its investment in AetherWorks on the equity method and has recorded in 1997 a \$5.8 million loss which represents 100% of the AetherWorks' net loss for the year ended September 30, 1997. The percentage of AetherWorks' losses included in the Company's results of operations is based upon the percentage of financial support provided by the Company (versus other investors) to AetherWorks during fiscal 1997.

Because of the significant uncertainty of the future of AetherWorks Corporation, as demonstrated by its lack of generating positive cash flow, obtaining other sources of equity financing and its continued uncertainty in developing commercially marketable products, the Company decided, as of September 30, 1997, to write-off its remaining investment of \$2.4 million in AetherWorks, and to accrue and expense its remaining future obligation to purchase additional notes of \$2 million. In addition, it has accrued \$1.4 million for its probable obligations resulting from its guarantees of certain AetherWorks lease obligations.

During the year ended September 30, 1997, two customers comprised more than 10% of net sales: Ingram Micro at 15.1%, and Tech Data at 10.5%. For 1996, two customers accounted for more than 10% of net sales: Tech Data at 13.9% and Ingram Micro at 13.4%. During 1995, two companies comprised more than 10% of net sales: Ingram Micro accounted for 12.5% and IBM accounted for 11.7% of net sales.

As of September 30, 1997, the Company had backlog orders which management believed to be firm in the amount of \$14.7 million. All of these orders are expected to be filled in the current fiscal year. Backlog at September 30, 1996 was \$0.967 million.

During fiscal years 1995, 1996 and 1997, the Company's net sales to customers outside the United States, primarily in Europe, amounted to approximately \$33 million, \$39.9 million and \$39.6 million respectively, comprising approximately 20%, 20% and 23.9% of net sales for the applicable fiscal year.

On February 13, 1997, the Company's Board of Directors approved a restructuring plan which resulted in a restructuring charge of \$10,471,482 (\$8,283,681, net of tax benefits or \$0.62 per share). The corporate restructuring plan simplified operations, increased consolidation and reduced costs and expenses. It included the closing of the Cleveland manufacturing facility, the reduction of selected product lines and the consolidation and

closing of the Torrance, California and Nashville, Tennessee research and development facilities. These costs included (i) write downs of the carrying values of fixed assets related to the closed manufacturing and research and development facilities, (ii) write downs of the carrying values of good will and identifiable intangible assets (primarily licensing agreements related to the discontinued product lines) and related inventories and (iii) severance costs associated with the elimination of 105 positions.

Subsequent to the actions covered by the restructuring charge, the Company has made additional headcount reductions and has consolidated other research and development activities into Minneapolis.

During the fourth quarter, the Company consolidated research and development activities from facilities in Cleveland, Ohio; Redmond, Washington; and, Huntsville, Alabama to the Company's corporate headquarters in Minneapolis, Minnesota. Additional headcount reductions have been made in varying levels throughout the Company, reflecting the consolidation of duties and responsibilities at the corporate headquarters.

Actual headcount at September 30, 1997 was 481.

ITEM 2. PROPERTIES

The Company's headquarters and research facilities are located in a 130,000 square foot office building in Minnetonka, Minnesota which the Company acquired in August 1995 and has occupied since March 1996. The Company's primary manufacturing facility is currently located in a 58,000 square foot building in Eden Prairie, Minnesota, which the Company purchased in May 1993 and has occupied since August 1993. Additional office and research facilities include a 46,170 square foot facility in Sunnyvale, California, the lease for which expires in April 2002. Facilities which were closed as part of the Company's restructuring, announced on February 13, 1997, included a 32,000 square foot facility in Twinsburg, Ohio, and a 10,525 square foot building in Torrance, California. Facilities which were closed, subsequent to the restructuring, and the space subleased included an 8,028 square foot research facility in Huntsville, Alabama, the sublease for which expires in February 1999; a 4,886 square foot research facility in Redmond, Washington the sublease for which expires in December 1998; and, a 17,146 square foot facility in Nashville, Tennessee, the sublease for which expires in August 2000.

The Company's sales support office in Germany is located in a 4,535 square foot office in Cologne, Germany, the lease for which expires in November 1998. The Company's sales support office in Asia is located in a 1,560 square foot office in Singapore, the lease for which expires in May 2000. The Company's sales support office in Australia is located in a 1,000 square foot office in Sydney, the lease for which expires in March 1998. The Company's sales support office in Hong Kong is located in a 1,400 square foot office in Causeway Bay, the lease for which expires in May 1998. The Company's sales support office in London is located in a 2,000 square foot office, the lease for which expires in June 2002. The Company's sales support office in Paris is located in a 625 square foot office, the lease for which expires with a 30 day notice. Management believes that the Company's

facilities are suitable and adequate for current office, research and warehouse requirements, and that its manufacturing facilities provide sufficient production capacity to meet the Company's currently anticipated needs.

ITEM 3. LEGAL PROCEEDINGS

On January 3, 1997, the Company and certain of its previous officers were named as defendants in a putative securities class action lawsuit in the United States District Court for the District of Minnesota on behalf of an alleged class of purchasers of its common stock during the period January 25, 1996, through December 23, 1996. Between January 17, 1997 and March 7, 1997, four similar putative securities class actions also were commenced. By Memorandum and Order dated April 2, 1997, the District Court consolidated all five of the putative securities class actions for all purposes including trial, appointed 21 persons to serve as lead plaintiffs in the consolidated class actions, and allowed the lead plaintiffs to file and serve a consolidated class action complaint.

On May 12, 1997, a consolidated amended class action complaint (the "Consolidated Amended Complaint") was filed in the combined actions, which are captioned IN RE DIGI INTERNATIONAL INC. SECURITIES LITIGATION, Master File No. 97-5 (JRT/RLE) (U.S. District Court for the District of Minnesota). The Consolidated Amended Complaint alleges that the Company and its previous officers Ervin F. Kamm, Jr., Gerald A. Wall and Gary L. Deaner violated the federal securities laws by, among other things, misrepresenting and/or omitting material information concerning the Company's operations and financial results. The Consolidated Amended Complaint seeks compensatory damages in an unspecified amount plus interest against all defendants, jointly and severally, and an award of attorneys' fees, experts' fees and costs.

On July 3, 1997, defendants served a motion to dismiss the Consolidated Amended Complaint on the ground, among others, that it fails to plead claims in accordance with applicable law. The motion to dismiss was argued before the District Court on October 31, 1997. A ruling has not yet been received.

On February 25, 1997, the Company and certain of its previous officers also were named as defendants in a securities lawsuit filed in the United States District Court for the District of Minnesota by the Louisiana State Employees Retirement System and entitled LOUISIANA STATE EMPLOYEES RETIREMENT SYSTEM IN BEHALF OF ITSELF AND IN BEHALF OF ALL OTHER PARTIES SIMILARLY SITUATED AND CIRCUMSTANCED WHO DESIRE TO PERSONALLY JOIN IN THIS ACTION AND TO CONTRIBUTE TO THE COSTS AND EXPENSES THEREOF, PLAINTIFFS, VS. DIGI INTERNATIONAL INC., GARY L. DEANER, ERVIN F. KAMM, JR., GERALD A. WALL, AND "JOHN DOE AND "RICHARD ROE", THE NAMES "JOHN DOE" AND "RICHARD ROE" BEING FICTITIOUS, THE PARTIES INTENDED BEING THOSE PARTIES, PRESENTLY UNKNOWN TO THE PLAINTIFF, WHO PARTICIPATED IN THE WRONGFUL ACTS SET FORTH HEREIN, DEFENDANTS, Civil File No. 97-440, Master File No. 97-5 (JRT/RLE) (U.S. District Court for the District of Minnesota). On June 3, 1997, the Louisiana State Employees Retirement System filed an Amended Complaint (the "Louisiana Amended Complaint"). The Louisiana Amended Complaint alleges that the Company and its previous officers Ervin F. Kamm, Jr., Gerald A. Wall and Gary L. Deaner violated

federal securities laws and state common law by, among other things, misrepresenting and/or omitting material information concerning the Company's operations and financial results.

The Louisiana Amended Complaint seeks compensatory damages in the amount of \$718,404.70 plus interest against all defendants, jointly and severally, and an award of attorneys' fees, disbursements and costs. This action has been consolidated with the consolidated class actions for pretrial purposes.

On July 17, 1997, defendants served a motion to dismiss the Louisiana Amended Complaint on the ground, among others, that it fails to plead claims in accordance with applicable law. The motion to dismiss was argued before the District Court on October 31, 1997. A ruling has not yet been received.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the quarter ended September 30, 1996.

PART II

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Not applicable.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. EXECUTIVE OFFICERS OF THE REGISTRANT

As of the date of filing this Form 10-K, the following individuals were executive officers of the Registrant:

Name	Age	Position
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John P. Schinas	60	Chairman of the Board of Directors
Jerry A. Dusa	50	Director, President and Chief Executive Officer

Jonathon E. Killmer	56	Senior Vice President, Chief Financial Officer and Treasurer
Douglas J. Glader	54	Senior Vice President, Manufacturing Operations
Dino G. Kasdagly	43	Senior Vice President, Development

Mr. Schinas, founder of the Company, retired as Chief Executive Officer effective January 27, 1992. He has been a member of the Board of Directors since the Company's inception in July 1985 and was elected Chairman of the Board of Directors in July 1991. From July 1985 to July 1991, Mr. Schinas also served the Company as President and Treasurer.

Mr. Dusa has been a member of the Board of Directors and President and Chief Executive Officer of the Company since March 12, 1997, after serving the Company as interim acting Chief Executive Officer from January 3, 1997 to March 12, 1997. Prior to January 3, 1997, Mr. Dusa had been the owner and principal of Phase One Partners, Inc., an investment and consulting business, since 1995 and had acted as a consultant to the Company in this capacity since August 1996. From 1994 to 1995, Mr. Dusa was Vice President of Fujitsu Microelectronics, Inc., a manufacturer of integrated circuit products. From 1993 to 1994, Mr. Dusa was President of Eagle Technology, a manufacturer of network connectivity products. From 1992 to 1993, Mr. Dusa was President of Kalpana, Inc., a manufacturer of network connectivity products. Prior to 1992, Mr. Dusa held executive management positions with a number of high technology companies including IBM Corporation, 3Com Corporation and Tandem Computers. Mr. Dusa is a director of Data Systems Network Corp., a data communications company.

Mr. Killmer joined the Company in October 1996, as Vice President, Chief Financial Officer and Treasurer. He was named Senior Vice President in July 1997. Prior to joining the Company, Mr. Killmer had been a partner in the professional services firm of Coopers & Lybrand L.L.P., most recently as the Managing Partner of the Minneapolis/St. Paul office from 1990 until his joining the Company.

Mr. Glader was named Vice President of Operations in February 1995 and Senior Vice President, Manufacturing Operations, on April 23, 1997. Before that, he was formerly Director of Manufacturing and Operations for MILAN Technology Corporation, which the Company acquired in November 1993. He began his career with Memorex Corporation and also worked for Measurex Corporation, Altus Corporation and Direct Incorporated. He founded and was vice president of operations for Greyhawk Systems, Inc., a manufacturer of electronic imaging hardware and software.

Mr. Kasdagly joined the Company in October 1997, as Senior Vice President, Development. Prior to joining the Company, Mr. Kasdagly had been an executive with IBM Corporation

since November 1980, most recently as Director, Division Quality and Business Reengineering for IBM's AS/400 Division.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 10-K

(a) Consolidated Financial Statements and Schedules of the Company and Financial Statements of AetherWorks Corporation

1. Incorporated by reference to pages 21 through 32 of the Company's 1997 Annual Report to Stockholders:

Consolidated Statement of Operations for the fiscal years ended September 30, 1997, 1996 and 1995

Consolidated Balance Sheets as of September 30, 1997 and 1996

Consolidated Statement of Cash Flows for the fiscal years ended September 30, 1997, 1996 and 1995

Consolidated Statement of Stockholders' Equity for the fiscal years ended September 30, 1997, 1996 and 1995

Notes to Consolidated Financial Statements

Report of Independent Accountants

2. AetherWorks Corporation Financial Statements

Balance Sheets as of September 30, 1997 and 1996

Statement of Operations for the years ended September 30, 1997 and 1996 and period from February 24, 1993 (inception) to September 30, 1997

Statement of Shareholders' Equity (Deficit) for the years ended September 30, 1997 and 1996 and period from February 24, 1993 (inception) to September 30, 1997

Statement of Cash Flows for the years ended September 30, 1997 and 1996 and period from February 24, 1993 (inception) to September 30, 1997

Notes to Financial Statements

Report of Independent Accountants

3. Included in Part II:

Report of Independent Accountants on Financial Statement Schedule

Schedule II - Valuation and Qualifying - Accounts

All other schedules are omitted because they are not applicable or are not required.

(b) Reports on Form 8-K

Form 8-K dated February 18, 1997, regarding the announcement of the Company recording a restructuring charge during the second quarter of fiscal 1997.

(c) Exhibits

Exhibit Number -----	Description -----
3(a)	Restated Certificate of Incorporation of the Registrant (4)
3(b)	Amended and Restated By-Laws of the Registrant (2)
10(a)	Stock Option Plan of the Registrant
10(b)	Form of indemnification agreement with directors and officers of the Registrant (1)
10(c)	Amended and Restated Employment Agreement between the Company and John P.Schinas (5)
10(d)	Restated and Amended Note Purchase Agreement between the Company and AetherWorks Corporation, dated October 14, 1997
10(e)	Employment Arrangement between the Registrant and Mike Kelley, dated February 7, 1996 (8)
10(f)	401(k) Savings and Profit Sharing Plan of Digi International Inc. (3)
10(h)	Consulting Agreement between the Company and Mykola Moroz (5)
10(i)	Employment Arrangement between the Registrant and Jonathon E. Killmer, dated September 16, 1996 (8)
10(j)	Employment Arrangement between the Registrant and David Rzasa, dated September 30, 1996 (8)
10(k)	Separation Agreement between the Company and Gerald A. Wall, dated December 4, 1996 (8)
10(l)	Separation Agreement between the Company and Ervin F. Kamm, Jr. dated January 3, 1997 (9)

- 10(m) Employment Agreement between the Company and Jerry A. Dusa, dated March 12, 1997 (10)
- 10(n) Employment Agreement with Ray D. Wymer, as amended by Amendment No. 1 to Employment Agreement (7)
- 10(p) Employment Arrangement between the Registrant and Douglas Glader (7)
- 10(p) (i) Amendment to Employment Agreement between the Company and Douglas Glader (9)
- 10(q) Employment Agreement between the Registrant and Dana R. Nelson for fiscal 1995 and 1996 (7)
- 10(r) Employment Agreement between the Company and Dino G. Kasdagly, dated October 1, 1997
- 10(s) Employee Stock Purchase Plan of the Registrant (6)
- 13 1997 Annual Report to Stockholders (only those portions specifically incorporated by reference herein shall be deemed filed with the Securities and Exchange Commission)
- 21 Subsidiaries of the Registrant
- 23.1 Consent of Independent Accountants
- 23.2 Consent of Independent Accountants
- 24 Powers of Attorney
- 27 Financial Data Schedule

- (1) Incorporated by reference to the corresponding exhibit number of the Company's Registration Statement on Form S-1 (File no. 33-30725).
- (2) Incorporated by reference to the corresponding exhibit number of the Company's Registration Statement on Form S-1 (File no. 33-42384).
- (3) Incorporated by reference to the corresponding exhibit number of the Company's Form 10-K for the year ended September 30, 1991 (File no. 0-17972).
- (4) Incorporated by reference to the corresponding exhibit number of the Company's Form 10-K for the year ended September 30, 1993 (File no. 0-17972).
- (5) Incorporated by reference to the corresponding exhibit number of the Company's Form 10-K for the year ended September 30, 1994 (File no. 0-17972).

- (6) Incorporated by reference to Exhibit B to the Registrant's Proxy Statement for its Annual Meeting of Stockholders held on January 31, 1996.
- (7) Incorporated by reference to the corresponding exhibit number of the Company's Form 10-K for the year ended September 30, 1995 (File no. 0-17972).
- (8) Incorporated by reference to the corresponding exhibit number of the Company's Form 10-K/A for the year ended September 30, 1996 (File no. 0-17972).
- (9) Incorporated by reference to the corresponding exhibit number of the Company's Form 10-Q for the quarter ended December 31, 1996 (File no. 0-17972).
- (10) Incorporated by reference to the corresponding exhibit number of the Company's Form 10-Q for the quarter ended March 31, 1997 (File no. 0-17972).

AetherWorks Corporation
(A Development Stage Company)

Balance Sheets

	SEPTEMBER 30	
	1997	1996

ASSETS		
Current assets:		
Cash and cash equivalents	\$ 874,265	\$ -
Prepaid expenses	81,430	104,307

Total current assets	955,695	104,307
Property and equipment:		
Computer hardware	3,457,408	3,049,813
Computer software	523,387	754,865
Furniture and fixtures	832,471	189,053

	4,813,266	3,993,731
Less accumulated depreciation and amortization		
	739,635	124,485

	4,073,631	3,869,246
Other assets:		
Deferred financing costs, net of accumulated amortization of \$376,114 in 1997 and \$113,359 in 1996	429,025	321,779
Note receivable from related party	120,536	112,447

Total assets	\$ 5,578,887	\$4,407,779

LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 602,455	\$2,522,138
Accrued interest	3,417	492,690
Current portion of long-term debt and capital lease obligations	861,964	927,204

Total current liabilities	1,467,836	3,942,032
Long-term debt and capital lease obligations		
	16,016,747	6,105,467
Shareholders' equity (deficit):		
Common Stock, par value \$.01 per share:		
Authorized shares - 10,000,000		
Issued and outstanding shares - 1,200,409 in 1997 and 1,126,700 in 1996	12,004	11,267
Additional paid-in capital	660,775	204,486
Deficit accumulated during the development stage	(12,578,475)	(5,855,473)

Total shareholders' equity (deficit)	(11,905,696)	(5,639,720)

Total liabilities and shareholders' equity (deficit)	\$ 5,578,887	\$4,407,779

SEE ACCOMPANYING NOTES.

AetherWorks Corporation
(A Development Stage Company)

Statements of Operations

	YEAR ENDED SEPTEMBER 30		PERIOD FROM FEBRUARY 24, 1993 (INCEPTION) TO SEPTEMBER 30, 1997
	1997	1996	1997
Operating expenses:			
Research and development	\$ 3,505,134	\$ 2,567,844	\$ 7,325,434
General and administrative	2,069,304	999,247	3,858,650
Operating loss	(5,574,438)	(3,567,091)	(11,184,084)
Other income (expense):			
Interest income	24,734	56,640	81,374
Interest (expense)	(1,173,298)	(537,625)	(1,783,519)
Net loss for the period	\$(6,723,002)	\$(4,048,076)	\$(12,886,229)
Net loss per share	\$(5.72)	\$(3.59)	\$(13.21)
Weighted average number of shares outstanding during the period	1,175,570	1,126,700	975,723

SEE ACCOMPANYING NOTES.

AetherWorks Corporation
(A Development Stage Company)

Statement of Shareholders' Equity (Deficit)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	DEFICIT ACCUMULATED DURING THE DEVELOPMENT STAGE	TOTAL
	SHARES	AMOUNT			
Balance at February 24, 1993 (inception)	-	\$ -	\$ -	\$ -	\$ -
Sale of Common Stock at \$.01 per share to the founder in June 1993	600,000	6,000	507	-	6,507
Sale of Common Stock at \$.71 per share between March 1993 and March 1994	105,000	1,050	73,950	-	75,000
Sale of Common Stock at \$.93 per share in January 1994	7,500	75	6,925	-	7,000
Sale of Common Stock at \$.43 per share in January 1994	23,333	233	9,767	-	10,000
Sale of Common Stock at \$.80 per share in March 1994	37,500	375	29,625	-	30,000
Sale of Common Stock at \$1.11 per share in March 1994	126,000	1,260	138,740	-	140,000
Sale of Common Stock at \$.19 per share in March 1994	30,000	300	5,250	-	5,550
Net loss for the period	-	-	-	(180,764)	(180,764)
Balance at March 31, 1994	929,333	9,293	264,764	(180,764)	93,293
Sale of Common Stock at \$1.11 per share in April 1994	28,286	283	31,146	-	31,429
Sale of Common Stock at \$.43 per share in May 1994	81,667	817	34,183	-	35,000
Sale of Common Stock at \$1.11 per share in May 1994	70,714	707	77,864	-	78,571
Value of warrants granted to consultants for services in May 1994	-	-	2,250	-	2,250
Sale of Common Stock at \$6.00 per share in June 1994	15,033	150	90,050	-	90,200
Note payable converted to Common Stock at \$6.00 per share in January 1995	1,667	17	9,983	-	10,000
Recapitalization resulting from election of C Corporation status	-	-	(307,754)	307,754	-
Net loss for the period	-	-	-	(1,934,387)	(1,934,387)
Balance at September 30, 1995	1,126,700	11,267	202,486	(1,807,397)	(1,593,644)
Value of warrants issued in connection with note payable in October 1995	-	-	2,000	-	2,000
Net loss for the year	-	-	-	(4,048,076)	(4,048,076)
Balance at September 30, 1996	1,126,700	11,267	204,486	(5,855,473)	(5,639,720)
Value of warrants granted for services in June 1997	-	-	14,772	-	14,772
Notes payable converted to Common Stock at \$6.00 per share in January 1997	73,209	732	438,522	-	439,254
Sale of Common Stock at \$6.00 per share in January 1997	500	5	2,995	-	3,000
Net loss for the year	-	-	-	(6,723,002)	(6,723,002)
Balance at September 30, 1997	1,200,409	\$12,004	\$660,775	\$(12,578,475)	\$(11,905,696)

SEE ACCOMPANYING NOTES.

AetherWorks Corporation
(A Development Stage Company)

Statements of Cash Flows

	YEAR ENDED SEPTEMBER 30 1997	SEPTEMBER 30 1996	PERIOD FROM FEBRUARY 24, 1993 (INCEPTION) TO SEPTEMBER 30, 1997

OPERATING ACTIVITIES			
Net loss for the period	\$(6,723,002)	\$(4,048,076)	\$(12,886,229)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	877,904	247,268	1,132,416
Value of warrants granted in connection with note payable	-	2,000	2,000
Value of warrants granted for services	14,772	-	17,022
Changes in operating assets and liabilities:			
Prepaid expenses and other assets	14,788	(93,391)	(79,180)
Accounts payable and accrued liabilities	1,213,128	77,109	2,106,930

Net cash used in operating activities	(4,602,410)	(3,815,090)	(9,707,041)
INVESTING ACTIVITIES			
Purchases of property and equipment	(431,075)	(358,132)	(811,597)
Issuance of notes receivable from related party	-	(110,000)	(110,000)

Net cash used in investing activities	(431,075)	(468,132)	(921,597)
FINANCING ACTIVITIES			
Net proceeds from issuance of notes payable	6,580,000	4,861,386	12,255,533
Payments of debt and capital leases	(675,250)	(589,637)	(1,264,887)
Proceeds from sale of common stock	3,000	-	512,257

Net cash provided by financing activities	5,907,750	4,271,749	11,502,903

Increase (decrease) in cash and cash equivalents	874,265	(11,473)	874,265
Cash and cash equivalents at beginning of period	-	11,473	-

Cash and cash equivalents at end of period	\$ 874,265	\$ -	\$ 874,265

SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING ACTIVITIES			
Conversion of note payable for common stock	\$ 439,254	\$ -	\$ 439,254
Property and equipment acquired through financing agreements	(388,460)	(3,613,209)	(4,001,669)
Note payable for capital lease guarantee	370,000	-	370,000
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION			
Cash paid for interest	203,395	103,543	318,926

SEE ACCOMPANYING NOTES.

AetherWorks Corporation
(A Development Stage Company)

Notes to Financial Statements

September 30, 1997

1. DESCRIPTION OF BUSINESS

AetherWorks Corporation (the "Company") was formed on February 24, 1993 and is a development stage company engaged in the design and development of software which will integrate telephone, wireless electronic mail, facsimile, paging and internet access on to one hardware platform and software that provides a computer telephony framework on which software applications can operate in the telephony environment.

2. SUMMARY OF ACCOUNTING POLICIES

CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents are carried at cost which approximates market value.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets of five years.

DEFERRED FINANCING COSTS

Deferred financing costs consist of costs associated with issuing the 1995 Note Purchase Agreement (see Note 3) and are being amortized over 36 months.

INCOME TAXES

Income taxes are accounted for under the liability method. Deferred income taxes are provided for temporary differences between the financial reporting tax bases of assets and liabilities.

NET LOSS PER SHARE

Net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of common stock outstanding during the period presented. Common equivalent shares outstanding from stock options and warrants are excluded from the computation as their effect is antidilutive.

2. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

RESEARCH AND DEVELOPMENT

All research and development costs are charged to operations as incurred.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

STOCK-BASED COMPENSATION

The Company follows Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25), and related interpretations in accounting for its stock options. Under APB 25, no compensation expense is recognized when the exercise price of stock options equals the market price of the underlying stock on the date of grant.

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (Statement No. 123). Beginning October 1, 1996, the Company is subject to the pro forma disclosure requirements of net income and earnings per share as if Statement No. 123 had been used.

IMPAIRMENT OF LONG-LIVED ASSETS

The Company will record impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount.

RECLASSIFICATIONS

Certain amounts presented for fiscal 1996 have been reclassified to conform to the 1997 presentations.

3. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

Long-term debt, including capital leases, is:

	SEPTEMBER 30	
	1997	1996

Notes payable under Note Purchase Agreement:		
(see description of Note A below)	\$11,796,525	\$5,296,525
(see description of Note B below)	1,772,895	-
Note payable to the City of St. Paul	80,000	-
8.8% notes payable to vendor	-	280,710
Notes payable at interest rates from 8% to 9.75%	-	366,664
Capitalized leases	3,229,291	1,088,772

	16,878,711	7,032,671
Less current portion	861,964	927,204

	\$16,016,747	\$6,105,467

In August 1994 through June 1995, the Company entered into various note payable agreements ("Notes") which accrue interest ranging from 8.0% to 9.75% per annum. The unsecured Notes were due on various dates between October 1995 and March 1996. The outstanding principal balance on the Notes was \$366,664 as of September 30, 1996. The Notes include amounts due from certain shareholders of \$47,000 as of September 30, 1996. As of September 30, 1996, some of the Notes were beyond their maturity dates. The Notes were convertible at the holders' option into shares of the Company's common stock at \$6.00 per share and warrants to purchase, at \$7.20 per share, additional shares of common stock of the Company equal to ten percent of the number of shares acquired by the holders through conversion of the Notes. In January 1997 all of the note holders converted their notes to \$6.00 per share common stock as part of a Private Placement Memorandum dated January 31, 1997. This conversion relieved the Company of \$366,664 notes due in addition to accrued interest of \$72,590.

In October 1995, the Company entered into a 1995 Note Purchase Agreement ("the Agreement") with a data communications company ("Creditor"). Upon the closing of the Agreement, the Company issued a convertible note for \$3,363,235. The Creditor

3. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS (CONTINUED)

committed to provide additional funding in the event that certain milestones were attained, but had no obligation to provide continued funding in the event two or more milestones were missed.

In June 1996, the Company restated and amended the 1995 Note Purchase Agreement, principally to eliminate milestones set forth in the Agreement as well as to obtain additional financing to acquire and develop new technology and to modify the Creditor's option to convert all, but not less than all, of the aggregate outstanding principal and interest of the Note into between 51% and 62.7% of the common stock of the Company, depending on the amount of the Company's borrowings from the Creditor. Upon the closing of the 1996 Restated and Amended Note Purchase Agreement (the "1996 Note Purchase Agreement"), the Company issued an additional note to the Creditor in the amount of \$1,433,290. The 1996 Note Purchase Agreement also gives the Company the option to issue additional notes to the Creditor, provided that the aggregate amount of the additional notes does not exceed \$9 million. The Company had issued additional notes for \$500,000 as of September 30, 1996. In 1997, the Company issued additional notes for \$6,500,000 which brought the total amount of notes outstanding at September 30, 1997 to \$11,796,525. The notes bear interest at prime plus 3% (11.50% at September 30, 1997) with principal and interest payable on December 31, 1998.

In October 1997, the Company restated and amended the 1996 Note Purchase Agreement, principally to provide the Company the ability to pay back a portion of convertible notes. Upon the closing of the 1997 Note Purchase Agreement ("the 1997 Agreement"), the Company exchanged all outstanding convertible notes for a new convertible note ("Note A") to the Creditor in the amount of \$11,796,525. The 1997 Agreement also gives the Company the option to obtain additional advances from the Creditor, provided that the aggregate amount of the additional advances does not exceed \$2,000,000. Funds advanced to the Company will be added to Note A, which bears interest at prime plus 3%. The unpaid principal is payable on December 31, 1998. The note is convertible into common stock of the Company at varying rates based upon the amount of the outstanding debt.

If the Company does not pay the balance of Note A by December 31, 1998, the Agreement provides for the mandatory conversion of the entire balance due into shares of common stock. An optional conversion also exists if the Company undergoes an initial

3. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS (CONTINUED)

public offering prior to the due date or in the event of a majority sale of Company assets, a merger or consolidation, or the sale of 80% or more of the Company's outstanding capital stock to a party other than the Creditor or to any person who is a shareholder of the Company.

The Company also issued a second non-convertible note ("Note B") under the 1997 Agreement in the amount of \$1,802,626 to the Creditor. This amount consists of \$1,402,895 for all of the outstanding aggregate accrued interest at September 30, 1997 on the previously outstanding notes, \$29,731 for accrued interest to the date of the 1997 Agreement, and \$370,000 as consideration for certain lease guarantees provided by the Creditor. The outstanding balance of Note B will increase by the amount of interest that accrues on Note A. Note B bears interest at prime plus 3%. The unpaid principal and interest balance is payable on December 31, 2000.

On November 27, 1996, the Company entered into a promissory note (the "Note") for \$80,000 with the Housing and Redevelopment Authority of the City of Saint Paul. The Note bears interest at 10.25% per annum and is payable semi-annually through its maturity date of November 27, 2001. The Note was issued under the provisions of an accompanying loan agreement which allows for all or a portion of the Note to be forgiven based on defined employment levels and events of default which may accelerate the due date. The Company received the proceeds from this Note in June 1997 and has accrued \$3,417 in interest at September 30, 1997.

The carrying amounts of the Company's debt instruments in the balance sheets at September 30, 1997 and 1996 approximate fair value.

In connection with the financing agreements, the Company has incurred cumulative financing costs of \$805,139, including \$370,000 payable to the Creditor as compensation for their guarantee of certain lease agreements. This amount is being amortized over the respective terms of the related instruments through September 2002.

During fiscal 1996 and 1997, the Company leased certain equipment, computer hardware and computer software under several long-term lease agreements which are classified as capital leases. The Creditor of the Restated and Amended Note Purchase Agreement guaranteed the majority of the Company's lease agreements.

3. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS (CONTINUED)

Leased assets included in the accompanying balance sheet as of September 30, 1997 consist of:

Property and equipment:	
Computer hardware	\$2,992,073
Computer software	109,775
Furniture and fixtures	698,791

	3,800,639
Less accumulated amortization	561,310

Net assets under capital leases	\$3,239,329

Future minimum lease payments under capital leases and principal maturities of long-term debt consist of the following:

	CAPITAL LEASES	LONG-TERM DEBT	TOTAL

Year ending September 30:			
1998	\$1,148,933	\$ 20,847	\$ 1,169,780
1999	997,802	11,793,647	12,791,449
2000	969,427	1,793,740	2,763,167
2001	542,750	20,847	563,597
2002	266,896	20,339	287,235

Total minimum payments	3,925,808	13,649,420	17,575,228
Less amount representing interest	696,517	-	696,517

Present value of net minimum payments	3,229,291	13,649,420	16,878,711
Less current portion	848,993	12,971	861,964

Long-term debt and capital lease obligations	\$2,380,298	\$13,636,449	\$16,016,747

4. OPERATING LEASES

The Company leases various property and equipment under operating leases that expire on various dates through fiscal 1999. On August 13, 1996, the Company entered into an operating lease for its office facility in St. Paul, Minnesota and its technical facility in Santa Clara, California, on May 15, 1996, which expire in fiscal 2002 and 1999, respectively. Operating expenses including maintenance, certain utilities and insurance

4. OPERATING LEASES (CONTINUED)

are paid by the Company. The Company used office space of the Creditor per the 1995 Note Purchase Agreement (see Note 3) on a rent-free basis for the period from November 1, 1995 to September 30, 1996. Total rent expense under non-cancelable operating leases was \$352,951 and \$95,727 for the years ended September 30, 1997 and 1996, respectively.

Future minimum lease rental payments required under non-cancelable operating leases in excess of one year as of September 30, 1997 are as follows:

1998	\$356,898
1999	280,895
2000	130,310
2001	136,298
2002	71,143

	\$975,544

5. INCOME TAXES

Upon inception, the Company operated as an S Corporation whereby taxable income or loss is passed through to the shareholders. The Subchapter S election was terminated on May 31, 1994 and, as a result, the Company became subject to federal and state income taxes. Also, as of that date, the Company's accumulated deficit of \$307,754 incurred while the Company was an S Corporation was reclassified as additional paid-in capital.

At September 30, 1997 the Company had net operating loss carryforwards of approximately \$12,500,000 which are available to offset future taxable income and begin to expire in the year 2010 and are subject to limitations if significant ownership changes occur.

The deferred tax assets resulting from net operating loss carryforwards and other temporary differences are fully offset by a valuation allowance.

6. STOCK OPTIONS AND WARRANTS

The Company has a stock option plan (the 1997 Stock Option Plan) which provides for the granting of 300,267 incentive stock options to employees and nonqualified stock options to employees, directors, and consultants. The incentive stock options granted to employees vest according to a two-phase schedule. In phase one no options shall vest until the sooner of the following dates: (1) January 2, 1999, or (2) 90 days after the Company's initial public offering. Upon the occurrence of the sooner of the dates in phase one, options shall vest according to optionee's years of service with the Company, measured retroactively from the date of first employment with the Company and extending over a subsequent period of no longer than six years, beginning with 20% vesting on the first anniversary date of employment and increasing in 20% increments each year thereafter. The non-qualified stock options granted during fiscal year end September 30, 1997 vested immediately.

Stock options and warrants outstanding are summarized as follows:

	SHARES AVAILABLE FOR GRANT UNDER THE PLAN	PLAN OPTIONS OUTSTANDING		WARRANTS	WEIGHTED AVERAGE EXERCISE PRICE
		INCENTIVE	NON- QUALIFIED		
Balance at September 30, 1995			-	30,833	\$6.32
Warrants granted			-	1,667	7.20
Balance at September 30, 1996			-	32,500	6.37
Warrants granted			-	12,364	7.20
Establishment of plan	300,267	-	-	-	-
Options granted	(180,053)	155,043	25,010	-	7.20
Options canceled	22,685	(22,685)	-	-	7.20
Balance at September 30, 1997	142,899	132,358	25,010	44,864	\$7.06
Options and warrants exercisable at September 30, 1997		-	25,010	43,530	\$6.80
Options and warrants exercisable at September 30, 1996		-	-	30,833	\$6.32

FASB Statement No. 123 requires that the fair value of options granted during 1997 and 1996 and the pro forma impact on earnings be discussed when material. The impact was not material for 1997 and 1996.

7. LICENSE AGREEMENT

On June 28, 1996, the Company entered into a license agreement with an entity to acquire certain rights and documentation relating to speech input-output software. The Company paid a non-refundable engineering fee of \$125,010 and a royalty payment of \$10,000 upon the execution of the agreement. Subsequent to entering into the license agreement, the Company determined that the entity could not provide them with the product they had expected. Consequently the contract was canceled and the royalty and engineering fees were redeemed.

8. RELATED PARTY TRANSACTION

In June 1996, the Company loaned the President and Chief Executive Officer of the Company \$110,000 under a promissory note. The note, which bears interest at 7.25% per annum, is due on or before June 10, 2001.

9. BENEFIT PLAN

In May 1996, the Company established a defined contribution retirement plan covering substantially all employees under Section 401(k) of the Internal Revenue Code. The Company recorded an expense of \$51,196 and \$9,685 for contributions to the Plan for the years ended September 30, 1997 and 1996, respectively.

10. GOING CONCERN

As reflected in the accompanying financial statements, the Company has accumulated a deficit during its development stage. The Company may be unable to maintain solvency unless it continues to obtain additional financing to continue as a going concern. The Company intends to obtain additional debt or equity financing in fiscal 1998 to fund operations.

Because of uncertainties regarding the achievability of management's plans, no assurances can be given as to the Company's ability to continue in existence. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amount and classification of liabilities that may result from the possible inability of the Company to continue as a going concern.

Report of Independent Auditors

Board of Directors and Shareholders
AetherWorks Corporation

We have audited the accompanying balance sheets of AetherWorks Corporation (a development stage company) as of September 30, 1997 and 1996, and the related statements of operations, shareholders' equity (deficit) and cash flows for the years then ended and the period from February 24, 1993 (inception) to September 30, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AetherWorks Corporation (a development stage company) at September 30, 1997 and 1996, and the results of its operations and its cash flows for the years then ended and the period from February 24, 1993 (inception) to September 30, 1997, in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 10 to the financial statements, the Company's deficit accumulated during the development stage raises substantial doubt about its ability to continue as a going concern. The Company intends to obtain additional financing to permit it to continue its operations. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Ernst & Young LLP

Minneapolis, MN
October 28, 1997

REPORT OF INDEPENDENT ACCOUNTANTS

To the Stockholders and Board of Directors of
Digi International Inc.

Our report on the consolidated financial statements of Digi International Inc. has been incorporated by reference in this Form 10-K from page 32 of the 1997 Annual Report to Stockholders of Digi International Inc. In connection with our audits of such financial statements, we have also audited the related financial statement schedule listed in Item 14(a)3 on page 12 of this Form 10-K.

In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information required to be included therein.

COOPERS & LYBRAND L.L.P.

Minneapolis, Minnesota
December 15, 1997

Digi International Inc.
Schedule II
Valuation and Qualifying Accounts

		Balance at Beginning of Year	Charged to Expense	Charged to Other Accounts	Deductions from Allowance	Balance at End of Year
		-----	-----	-----	-----	-----
Deducted from Accounts Receivable- Allowance for Doubtful Accounts:						
Year ended September 30:	1995	\$641,500	\$243,895		\$228,895(1)	\$656,500
		-----	-----		-----	-----
	1996	\$656,500	\$262,164		\$183,222(1)	\$735,442
		-----	-----		-----	-----
	1997	\$735,442	\$1,533,251		\$1,488,940(1)	\$1,179,753
		-----	-----		-----	-----
Deducted from Inventory-Allowance for Inventory Obsolescence:						
Year ended September 30:	1995	\$682,000	\$716,300		\$586,300(2)	\$812,000
		-----	-----		-----	-----
	1996	\$812,000	\$1,455,895		\$1,099,735(2)	\$1,168,176
		-----	-----		-----	-----
	1997	\$1,168,176	\$2,910,988	\$2,936,967(3)	\$4,823,351(2)	\$2,192,780
		-----	-----	-----	-----	-----

(1) Uncollectible accounts charged against allowance.

(2) Scrapped inventory charged against allowance.

(3) Charged to restructuring.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DIGI INTERNATIONAL INC.

December 26, 1997

By: /s/ Jonathon E. Killmer

Date

Jonathon E. Killmer
Senior Vice President & Chief
Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

December 26, 1997

/s/ Jerry A. Dusa

Date

Jerry A. Dusa
President & Chief Executive Officer

December 26, 1997

/s/ Jonathon E. Killmer

Date

Jonathon E. Killmer
Senior Vice President & Chief
Financial Officer

JOHN P. SCHINAS
WILLIS K. DRAKE
JERRY A. DUSA
RICHARD E. EICHHORN
MYKOLA MOROZ
DAVID STANLEY
ROBERT S. MOE

A majority of the Board of Directors*

*Jonathon E. Killmer, by signing his name hereto, does hereby sign this document on behalf of each of the above named directors of the Registrant pursuant to Power of Attorney duly executed by such persons.

/s/ Jonathon E. Killmer

Jonathon E. Killmer,
Attorney-in-fact

INDEX TO EXHIBITS

Exhibit Number -----	Description -----	Page -----
3(a)	Restated Certificate of Incorporation of the Registrant (4) . .	
3(b)	Amended and Restated By-Laws of the Registrant (2)	
10(a)	Stock Option Plan of the Registrant.	
10(b)	Form of indemnification agreement with directors and officers of the Registrant (1)	
10(c)	Amended and Restated Employment Agreement between the Company and John P. Schinas (5).	
10(d)	Restated and Amended Note Purchase Agreement between the Company and AetherWorks Corporation, dated October 14, 1997	
10(e)	Employment Arrangement between the Registrant and Mike Kelley, dated February 7, 1996 (8).	
10(f)	401(k) Savings and Profit Sharing Plan of Digi International Inc. (3).	
10(h)	Consulting Agreement between the Company and Mykola Moroz (5)	
10(i)	Employment Arrangement between the Registrant and Jonathon E. Killmer, dated September 16, 1996 (8).	
10(j)	Employment Arrangement between the Registrant and David Rzasa, dated September 30, 1996 (8).	
10(k)	Separation Agreement between the Company and Gerald A. Wall, dated December 4, 1996 (8)	
10(l)	Separation Agreement between the Company and Ervin F. Kamm, Jr. dated January 3, 1997 (9)	
10(m)	Employment Agreement between the Company and Jerry A. Dusa, dated March 12, 1997 (10)	

INDEX TO EXHIBITS
(continued)

Exhibit Number -----	Description -----	Page -----
10(n)	Employment Agreement with Ray D. Wymer, as amended by Amendment No. 1 to Employment Agreement (7)	
10(p)	Employment Arrangement between the Registrant and Douglas Glader (7)	
10(p)(i)	Amendment to Employment Agreement between the company and Douglas Glader (9)	
10(q)	Employment Arrangement between the Registrant and Dana R. Nelson for fiscal 1995 and 1996 (7)	
10(r)	Employment Agreement between the Company and Dino Kasdagly, dated October 1, 1997	
10(s)	Employee Stock Purchase Plan of the Registrant (6)	
13	1997 Annual Report to Stockholders (only those portions specifically incorporated by reference herein shall be deemed filed with the Securities and Exchange Commission)	
21	Subsidiaries of the Registrant	
23.1	Consent of Independent Accountants	
23.2	Consent of Independent Accountants	
24	Powers of Attorney	
27	Financial Data Schedule.	

DIGI INTERNATIONAL INC.
STOCK OPTION PLAN
AS AMENDED AND RESTATED

1. PURPOSE OF PLAN. The purpose of this Digi International Inc. Stock Option Plan (the "Plan"), is to promote the interests of Digi International Inc., a Delaware corporation (the "Company"), and its stockholders by providing key personnel of the Company and its subsidiaries with an opportunity to acquire a proprietary interest in the Company and thereby develop a stronger incentive to put forth maximum effort for the continued success and growth of the Company and its subsidiaries. In addition, the opportunity to acquire a proprietary interest in the Company will aid in attracting and retaining key personnel of outstanding ability.

2. ADMINISTRATION OF PLAN. This Plan shall be administered by a committee of two or more directors (the "Committee") appointed by the Company's board of directors (the "Board"). No person shall serve as a member of the Committee unless such person shall be a "Non-Employee Director" as that term is defined in Rule 16b-3(a)(3)(i), promulgated under the Securities Exchange Act of 1934, as amended (the "Act"), or any successor statute or regulation comprehending the same subject matter. A majority of the members of the Committee shall constitute a quorum for any meeting of the Committee, and the acts of a majority of the members present at any meeting at which a quorum is present or the acts unanimously approved in writing by all members of the Committee shall be the acts of the Committee. Subject to the provisions of this Plan, the Committee may from time to time adopt such rules for the administration of this Plan as it deems appropriate. The decision of the Committee on any matter affecting this Plan or the rights and obligations arising under this Plan or any option granted hereunder, shall be final, conclusive and binding upon all persons, including without limitation the Company, stockholders, employees and optionees. To the full extent permitted by law, (i) no member of the Committee or the CEO Stock Option Committee (as defined in this paragraph 2) shall be liable for any action or determination taken or made in good faith with respect to this Plan or any option granted hereunder and (ii) the members of the Committee and the CEO Stock Option Committee shall be entitled to indemnification by the Company against and from any loss incurred by such member or person by reason of any such actions and determinations. The Committee may delegate all or any part of its authority under this Plan to a one person committee consisting of the Chief Executive Officer of the Company as its sole member (the "CEO Stock Option Committee") for purposes of granting and administering awards granted to persons other than persons who are then subject to the reporting requirements of Section 16 of the Exchange Act ("Section 16 Individuals").

3. SHARES SUBJECT TO PLAN. The shares that may be made subject to options granted under this Plan shall be authorized and unissued shares of common stock (the "Common Shares") of the Company, \$.01 par value, or Common Shares held in treasury, and they shall not exceed 4,129,400 in the aggregate, except that, if any option lapses or terminates for any reason before such option has been completely exercised, the Common Shares covered by the unexercised portion of such option may again be made subject to options granted under this Plan. Appropriate adjustments in the number of shares and in the purchase price per share may be made by the Committee in its sole discretion to give effect to adjustments made in the number of outstanding Common Shares of the Company

through a merger, consolidation, recapitalization, reclassification, combination, stock dividend, stock split or other relevant change, provided that fractional shares shall be rounded to the nearest whole share.

4. ELIGIBLE PARTICIPANTS. Options may be granted under this Plan to any key employee of the Company or any subsidiary thereof, including any such employee who is also an officer or director of the Company or any subsidiary thereof. Nonstatutory stock options, as defined in paragraph 5(a) hereof, also shall be granted to directors of the Company who are not employees of the Company or any subsidiary thereof (the "Outside Directors") in accordance with paragraph 6 hereof and may also be granted to other individuals or entities who are not "employees" but who provide services to the Company or a parent or subsidiary thereof in the capacity of an Outside Director, advisor or consultant. References herein to "employed," "employment" and similar terms (except "employee") shall include the providing of services in any such capacity or as a director. The employees and other individuals and entities to whom options may be granted pursuant to this paragraph 4 are referred to herein as "Eligible Participants."

5. TERMS AND CONDITIONS OF EMPLOYEE OPTIONS.

(a) Subject to the terms and conditions of this Plan, the Committee may, from time to time prior to December 1, 2006, grant to such Eligible Participants as the Committee may determine options to purchase such number of Common Shares of the Company on such terms and conditions as the Committee may determine; provided, however, that no Eligible Participant may be granted options with respect to more than 250,000 Common Shares during any calendar year. In determining the Eligible Participants to whom options shall be granted and the number of Common Shares to be covered by each option, the Committee may take into account the nature of the services rendered by the respective Eligible Participants, their present and potential contributions to the success of the Company, and such other factors as the Committee in its sole discretion shall deem relevant. The date and time of approval by the Committee of the granting of an option shall be considered the date and the time of the grant of such option. The Committee in its sole discretion may designate whether an option granted to an employee is to be considered an "incentive stock option" (as that term is defined in Section 422 of the Internal Revenue Code of 1986, as amended, or any amendment thereto (the "Code")) or a nonstatutory stock option (an option granted under this Plan that is not intended to be an "incentive stock option"). The Committee may grant both incentive stock options and nonstatutory stock options to the same employee. However, if an incentive stock option and a nonstatutory stock option are awarded simultaneously, such options shall be deemed to have been awarded in separate grants, shall be clearly identified, and in no event shall the exercise of one such option affect the right to exercise the other. To the extent that the aggregate Fair Market Value (as defined in paragraph 5(c)) of Common Shares with respect to which incentive stock options (determined without regard to this sentence) are exercisable for the first time by any individual during any calendar year (under all plans of the Company and its parent and subsidiary corporations) exceeds \$100,000, such options shall be treated as nonstatutory stock options.

(b) The purchase price of each Common Share subject to an option granted pursuant to this paragraph 5 shall be fixed by the Committee. For nonstatutory stock options, such purchase price may be set at not less than 50% of the Fair Market Value (as defined below) of a Common Share on the date of grant. For incentive stock options, such purchase price shall be no less than 100% of the Fair Market Value of a Common Share on the date of grant, provided that if such incentive stock option is granted to an employee who owns, or is deemed under Section 424(d) of the Code to own, at the time such option is granted, stock of the Company (or of any parent or subsidiary of the Company) possessing more than 10% of the total combined voting power of all classes of stock therein (a "10% Stockholder"), such purchase price shall be no less than 110% of the Fair Market Value of a Common Share on the date of grant.

(c) For purposes of this Plan, the "Fair Market Value" of a Common Share at a specified date shall, unless otherwise expressly provided in this Plan, mean the closing sale price of a Common Share on the date immediately preceding such date or, if no sale of such shares shall have occurred on that date, on the next preceding day on which a sale of such shares occurred, on the Composite Tape for New York Stock Exchange listed shares or, if such shares are not quoted on the Composite Tape for New York Stock Exchange listed shares, on the principal United States securities exchange registered under the Act, on which the shares are listed, or, if such shares are not listed on any such exchange, on the National Association of Securities Dealers, Inc. Automated Quotation System/National Market System or any similar system then in use or, if such shares are not included in the National Association of Securities Dealers, Inc. Automated Quotation System/National Market System or any similar system then in use, the mean between the closing "bid" and the closing "asked" quotation of such a share on the date immediately preceding the date as of which such Fair Market Value is being determined, or, if no closing bid or asked quotation is made on that date, on the next preceding day on which a quotation is made, on the National Association of Securities Dealers, Inc. Automated Quotation System or any similar system then in use, provided that if the shares in question are not quoted on any such system, Fair Market Value shall be what the Committee determines in good faith to be 100% of the fair market value of such a share as of the date in question. Notwithstanding anything stated in this paragraph, if the applicable securities exchange or system has closed for the day by the time the determination is being made, all references in this paragraph to the date immediately preceding the date in question shall be deemed to be references to the date in question.

(d) Each option agreement provided for in paragraph 14 hereof shall specify when each option granted under this Plan shall become exercisable.

(e) Each option granted pursuant to this paragraph 5 and all rights to purchase shares thereunder shall cease on the earliest of:

(i) ten years after the date such option is granted (or in the case of an incentive stock option granted to a 10% Stockholder, five years after the date such

option is granted) or on such date prior thereto as may be fixed by the Committee on or before the date such option is granted;

(ii) the expiration of the period after the termination of the optionee's employment within which the option is exercisable as specified in paragraph 8(b) or 8(c), whichever is applicable; or

(iii) the date, if any, fixed for cancellation pursuant to paragraph 9 of this Plan.

In no event shall any option be exercisable at any time after its original expiration date. When an option is no longer exercisable, it shall be deemed to have lapsed or terminated and will no longer be outstanding.

6. TERMS AND CONDITIONS OF OUTSIDE DIRECTOR OPTIONS.

(a) Subject to the terms and conditions of this Plan, the Committee shall grant options to each Outside Director who is not on the date such option would be granted the beneficial owner (as defined in Rule 13d-3 under the Act) of more than 5% of the outstanding Common Shares, on the terms and conditions set forth in this paragraph 6. During the term of this Plan and provided that sufficient Common Shares are available pursuant to paragraph 3:

(i) each person who is an Outside Director at the conclusion of each Annual Meeting of Stockholders held prior to the date of the 1996 Annual Meeting of Stockholders shall be granted a nonstatutory stock option on the date of such Annual Meeting of Stockholders. The date of such Annual Meeting of Stockholders also shall be the date of grant for options granted pursuant to this subparagraph 6(a)(i). The number of Common Shares covered by each such option shall be 15,000 (7,500 on or after the 1992 Annual Meeting of Stockholders);

(ii) each person who is elected to be an Outside Director between Annual Meetings of Stockholders and prior to the date of the 1996 Annual Meeting of Stockholders shall be granted a nonstatutory stock option. The date such person is elected to be an Outside Director of the Company by the Board shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(ii). The number of Common Shares covered by each such option shall be 15,000 (7,500 on or after the 1992 Annual Meeting of Stockholders) multiplied by a fraction, the numerator of which shall be 12 minus the number of whole 30-day months that have elapsed from the date of the most recent Annual Meeting of Stockholders to the date such person is elected to be an Outside Director, and the denominator of which shall be 12;

(iii) each person who is elected to be an Outside Director at any time on or after the date of the 1996 Annual Meeting of Stockholders and who was not at any time previously a director of the Company shall be granted a nonstatutory stock option. The date such person is elected to be an Outside Director of the Company

shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(iii). The number of Common Shares covered by each such option shall be 5,000;

(iv) each person who is an Outside Director at the conclusion of the 1996 Annual Meeting of Stockholders and at the conclusion of each Annual Meeting of Stockholders thereafter shall be granted a nonstatutory stock option on the date of such Annual Meeting of Stockholders. The date of such Annual Meeting of Stockholders shall also be the date of grant for options granted pursuant to this subparagraph 6(a)(iv). The number of Common Shares covered by each such option shall be 1,500;

(v) each person who is elected to be an Outside Director between Annual Meetings of Stockholders and after the date of the 1996 Annual Meeting of Stockholders shall be granted a nonstatutory stock option. The date such person is elected to be an Outside Director of the Company by the Board shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(v). The number of Common Shares covered by each such option shall be 1,500 multiplied by a fraction, the numerator of which shall be 12 minus the number of whole 30-day months that have elapsed from the date of the most recent Annual Meeting of Stockholders to the date such person is elected to be an Outside Director, and the denominator of which shall be 12;

(vi) each person who is an Outside Director at the conclusion of the 1996 Annual Meeting of Stockholders and each Annual Meeting of Stockholders thereafter may elect in writing to be granted a nonstatutory stock option on the date of such Annual Meeting of Stockholders in lieu of all cash compensation to which such Outside Director would be entitled for the Board year of the Company commencing with such Annual Meeting of Stockholders. The date of such Annual Meeting of Stockholders shall also be the date of grant for options granted pursuant to this subparagraph 6(a)(vi). The number of Common Shares covered by each such option shall be 6,000. Any such election by an Outside Director shall be subject to prior approval by the Committee; and

(vii) each person who is elected to be an Outside Director between Annual Meetings of Stockholders and after the date of the 1996 Annual Meeting of Stockholders may elect in writing to be granted a nonstatutory stock option in lieu of all cash compensation to which such Outside Director would otherwise be entitled for the period commencing with the date such person is elected to be an Outside Director of the Company by the Board and ending on the date of the next Annual Meeting of Stockholders. The date such person is elected to be an Outside Director of the Company by the Board shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(vii). The number of Common Shares covered by each such option shall be 6,000 multiplied by a fraction, the numerator of which shall be 12 minus the number of whole 30-day months that have elapsed

from the date of the most recent Annual Meeting of Stockholders to the date such person is elected to be an Outside Director, and the denominator of which shall be 12. Such election by an Outside Director shall be subject to prior approval by the Committee.

(b) The purchase price of each Common Share subject to an option granted to an Outside Director pursuant to this paragraph 6 shall be the Fair Market Value of a Common Share on the date of grant.

(c)(i) Subject to the provisions of paragraphs 6(e) and 6(f) hereof, the options granted to Outside Directors pursuant to subparagraph 6(a)(i) shall vest and become exercisable in accordance with the following schedule:

Annual Meeting of Stockholders -----	Cumulative Percentage ----- Becoming Exercisable -----
One Year After Grant	20%
Two Years After Grant	40%
Three Years After Grant	60%
Four Years After Grant	80%
Five Years After Grant	100%

(ii) Subject to the provisions of paragraph 6(e) hereof, the options granted to Outside Directors pursuant to subparagraph 6(a)(ii) shall vest and become exercisable in accordance with the following schedule:

Anniversary of the Date of Grant -----	Cumulative Percentage ----- Becoming Exercisable -----
One Year After Grant	20%
Two Years After Grant	40%
Three Years After Grant	60%
Four Years After Grant	80%
Five Years After Grant	100%

(iii) Subject to the provisions of paragraphs 6(e) and 6(f) hereof, (x) options granted to Outside Directors pursuant to subparagraph 6(a)(iv) and (vi) and (y) options granted to Outside Directors pursuant to subparagraph 6(a)(iii) if the date of grant of such options is the date of an Annual Meeting of Stockholders shall vest and become exercisable in accordance with the following schedule:

Annual Meeting of Stockholders -----	Cumulative Percentage ----- Becoming Exercisable -----
One Year After Grant	50%
Two Years After Grant	100%

(iv) Subject to the provisions of paragraph 6(e) and 6(f) hereof, (x) the options granted to Outside Directors pursuant to subparagraphs 6(a)(v) and (vii) and (y) options granted to Outside Directors pursuant to subparagraph 6(a)(iii) if the date of grant of such options is a date other than the date of an Annual Meeting of Stockholders shall vest and become exercisable in accordance with the following schedule:

Anniversary of the Date of Grant -----	Cumulative Percentage ----- Becoming Exercisable -----
One Year After Grant	50%
Two Years After Grant	100%

(d) Notwithstanding the terms of paragraphs 6(a), 6(b) and 6(c) hereof, options shall be granted to Willis K. Drake ("Drake") and to Richard E. Eichhorn ("Eichhorn"), on the effective date of the merger (the "Merger") of Digiboard, Inc., a Minnesota corporation, with and into the Company, to purchase (i) 15,000 Common Shares at a purchase price of \$.50 per share, in substitution for options previously granted to Drake and Eichhorn on October 1, 1987 (the "1987 Options"), which 1987 Options shall vest and become exercisable in accordance with the following schedule:

Date ----	Cumulative Percentage ----- Becoming Exercisable -----
Effective Date of this Plan	20%
October 1, 1989	40%
October 1, 1990	60%
October 1, 1991	80%
October 1, 1992	100%

and (ii) 15,000 Common Shares at a purchase price of \$.50 per share, in substitution for options previously granted to Drake and Eichhorn on October 1, 1988 (the "1988 Options"), which 1988 Options shall vest and become exercisable in accordance with the following schedule:

Date	Cumulative Percentage ----- Becoming Exercisable -----
October 1, 1989	20%
October 1, 1990	40%
October 1, 1991	60%
October 1, 1992	80%
October 1, 1993	100%

(e) Notwithstanding the vesting schedules set forth in paragraphs 6(c) and 6(d) hereof, an option held by an Outside Director shall vest and become immediately exercisable upon the latest of (i) the date on which such Outside Director attains 62 years of age, (ii) the date on which such Outside Director has completed five years of Service (as hereinafter defined) and (iii) the first anniversary of the date of grant of such option or, if applicable, the Annual Meeting of Stockholders next succeeding the Annual Meeting at which such option was granted. Any option granted to an Outside Director on or after the first accelerated vesting date for such Outside Director shall automatically vest on the Annual Meeting of Stockholders next succeeding the Annual Meeting at which such option was granted. As used herein, "Service" shall mean service to the Company or any subsidiary thereof in the capacity of any advisor, consultant, employee, officer or director, and Service as a director from an Annual Meeting of Stockholders to the next succeeding Annual Meeting shall constitute a year of Service, notwithstanding that such period may actually be more or less than one year.

(f) Each option granted to an Outside Director pursuant to this paragraph 6 and all rights to purchase shares thereunder shall terminate on the earliest of:

(i) ten years after the date such option is granted; provided, however, that the 1987 Options shall terminate on September 30, 1997, and the 1988 Options shall terminate on September 30, 1998;

(ii) the expiration of the period specified in paragraph 8(b) or 8(c), whichever is applicable, after an Outside Director ceases to be a director of the Company; or

(iii) the date, if any, fixed for cancellation pursuant to paragraph 9 of this Plan.

In no event shall such option be exercisable at any time after its original expiration date. When an option is no longer exercisable, it shall be deemed to have lapsed or terminated and will no longer be outstanding.

7. MANNER OF EXERCISING OPTIONS. A person entitled to exercise an option granted under this Plan may, subject to its terms and conditions and the terms and conditions of this Plan, exercise it in whole at any time, or in part from time to time, by delivery to the Company at its principal

executive office, to the attention of its President, of written notice of exercise, specifying the number of shares with respect to which the option is being exercised, accompanied by payment in full of the purchase price of the shares to be purchased at the time. The purchase price of each share on the exercise of any option shall be paid in full in cash (including check, bank draft or money order) at the time of exercise or, at the discretion of the holder of the option, by delivery to the Company of unencumbered Common Shares having an aggregate Fair Market Value on the date of exercise equal to the purchase price, or by a combination of cash and such unencumbered Common Shares. No shares shall be issued until full payment therefor has been made, and the granting of an option to an individual shall give such individual no rights as a stockholder except as to shares issued to such individual.

8. TRANSFERABILITY AND TERMINATION OF OPTIONS.

(a) During the lifetime of an optionee, only such optionee or his or her guardian or legal representative may exercise options granted under this Plan, and no option granted under this Plan shall be assignable or transferable by the optionee otherwise than by will or the laws of descent and distribution or pursuant to a domestic relations order as defined in the Code or Title I of the Employee Retirement Income Security Act ("ERISA"), or the rules thereunder; provided, however, that any optionee may transfer a nonstatutory stock option granted under this Plan to a member or members of his or her immediate family (i.e., his or her children, grandchildren and spouse) or to one or more trusts for the benefit of such family members or partnerships in which such family members are the only partners, if (i) the option agreement with respect to such options, which must be approved by the Committee, expressly so provides either at the time of initial grant or by amendment to an outstanding option agreement and (ii) the optionee does not receive any consideration for the transfer. Any options held by any such transferee shall continue to be subject to the same terms and conditions that were applicable to such options immediately prior to their transfer and may be exercised by such transferee as and to the extent that such option has become exercisable and has not terminated in accordance with the provisions of the Plan and the applicable option agreement. For purposes of any provision of this Plan relating to notice to an optionee or to vesting or termination of an option upon the death, disability or termination of employment of an optionee, the references to "optionee" shall mean the original grantee of an option and not any transferee.

(b) During the lifetime of an optionee, an option may be exercised only while the optionee is employed by the Company or a parent or subsidiary thereof, and only if such optionee has been continuously so employed since the date the option was granted, except that:

(i) an option granted to an optionee who is not an Outside Director shall continue to be exercisable for three months after termination of such optionee's employment but only to the extent that the option was exercisable immediately prior to such optionee's termination of employment, and an option granted to an optionee who is an Outside Director shall continue to be exercisable after such Outside

Director ceases to be a director of the Company but only to the extent that the option was exercisable immediately prior to such Outside Director's ceasing to be a director;

(ii) in the case of an optionee who is disabled (within the meaning of Section 22(e)(3) of the Code) while employed, the option granted to such optionee may be exercised within one year after termination of such optionee's employment; and

(iii) as to any optionee whose termination occurs following a declaration pursuant to paragraph 9 of this Plan, the option granted to such optionee may be exercised at any time permitted by such declaration.

(c) An option may be exercised after the death of the optionee, but only within one year after the death of such optionee.

(d) In the event of the disability (within the meaning of Section 22(e)(3) of the Code) or death of an optionee, any option granted to such optionee that was not previously exercisable shall become immediately exercisable in full if the disabled or deceased optionee shall have been continuously employed by the Company or a parent or subsidiary thereof between the date such option was granted and the date of such disability, or, in the event of death, a date not more than three months prior to such death.

9. DISSOLUTION, LIQUIDATION, MERGER. In the event of (a) a proposed merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, unless appropriate provision shall have been made for the protection of the outstanding options granted under this Plan by the substitution, in lieu of such options, of options to purchase appropriate voting common stock (the "Survivor's Stock") of the corporation surviving any such merger or consolidation or, if appropriate, the parent corporation of the Company or such surviving corporation, or, alternatively, by the delivery of a number of shares of the Survivor's Stock which has a Fair Market Value as of the effective date of such merger or consolidation equal to the product of (i) the excess of (x) the Event Proceeds per Common Share (as hereinafter defined) covered by the option as of such effective date, over (y) the option price per Common Share, times (ii) the number of Common Shares covered by such option, or (b) the proposed dissolution or liquidation of the Company (such merger, consolidation, dissolution or liquidation being herein called an "Event"), the Committee shall declare, at least ten days prior to the actual effective date of an Event, and provide written notice to each optionee of the declaration, that each outstanding option, whether or not then exercisable, shall be cancelled at the time of, or immediately prior to the occurrence of, the Event (unless it shall have been exercised prior to the occurrence of the Event) in exchange for payment to the holder of each cancelled option, within ten days after the Event, of cash equal to the amount (if any), for each Common Share covered by the cancelled option, by which the Event Proceeds per Common Share (as hereinafter defined) exceeds the exercise price per Common Share covered by such option. At the time of the declaration provided for in the immediately preceding sentence, each option shall immediately become exercisable in full and each holder of an option shall have the right, during the period preceding the time of cancellation of the

option, to exercise his or her option as to all or any part of the Common Shares covered thereby. Each outstanding option granted pursuant to this Plan that shall not have been exercised prior to the Event shall be cancelled at the time of, or immediately prior to, the Event, as provided in the declaration, and this Plan shall terminate at the time of such cancellation, subject to the payment obligations of the Company provided in this paragraph 9. For purposes of this paragraph, "Event Proceeds per Common Share" shall mean the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Common Share by the stockholders of the Company upon the occurrence of the Event.

10. **SUBSTITUTION OPTIONS.** Options may be granted under this Plan from time to time in substitution for stock options held by employees of other corporations who are about to become employees of the Company or a subsidiary of the Company, or whose employer is about to become a subsidiary of the Company, as the result of a merger or consolidation of the Company or a subsidiary of the Company with another corporation, the acquisition by the Company or a subsidiary of the Company of all or substantially all the assets of another corporation or the acquisition by the Company or a subsidiary of the Company of at least 50% of the issued and outstanding stock of another corporation. The terms and conditions of the substitute options so granted may vary from the terms and conditions set forth in this Plan to such extent as the Board at the time of the grant may deem appropriate to conform, in whole or in part, to the provisions of the stock options in substitution for which they are granted, but with respect to stock options which are incentive stock options, no such variation shall be permitted which affects the status of any such substitute option as an incentive stock option under Section 422A of the Code.

11. **TAX WITHHOLDING.** Delivery of Common Shares upon exercise of any nonstatutory stock option granted under this Plan shall be subject to any required withholding taxes. A person exercising such an option may, as a condition precedent to receiving the Common Shares, be required to pay the Company a cash amount equal to the amount of any required withholdings. In lieu of all or any part of such a cash payment, the Committee may, but shall not be required to, permit the optionee to elect to cover all or any part of the required withholdings, and to cover any additional withholdings up to the amount needed to cover such optionee's full FICA and federal, state and local income tax liability with respect to income arising from the exercise of the option, through a reduction of the number of Common Shares delivered to the person exercising the option or through a subsequent return to the Company of shares delivered to the person exercising the option.

12. **TERMINATION OF EMPLOYMENT.** Neither the transfer of employment of an optionee between any combination of the Company, a parent corporation or a subsidiary thereof, nor a leave of absence granted to such optionee and approved by the Committee, shall be deemed a termination of employment for purposes of this Plan. The terms "parent" or "parent corporation" and "subsidiary" as used in this Plan shall have the meaning ascribed to "parent corporation" and "subsidiary corporation", respectively, in Sections 424(e) and (f) of the Code.

13. **OTHER TERMS AND CONDITIONS.** The Committee shall have the power, subject to the other limitations contained herein, to fix any other terms and conditions for the grant or exercise of any option under this Plan. Nothing contained in this Plan, or in any option granted pursuant to this Plan, shall confer upon any optionee any right to continued employment by the Company or any

parent or subsidiary of the Company or limit in any way the right of the Company or any such parent or subsidiary to terminate an optionee's employment at any time.

14. OPTION AGREEMENTS. All options granted under this Plan shall be evidenced by a written agreement in such form or forms as the Committee may from time to time determine, which agreement shall, among other things, designate whether the options being granted thereunder are nonstatutory stock options or incentive stock options under Section 422 of the Code.

15. AMENDMENT AND DISCONTINUANCE OF PLAN. The Board may at any time amend, suspend or discontinue this Plan; provided, however, that no amendment by the Board shall, without further approval of the Stockholders of the Company, if required in order for the Plan to continue to meet the requirements of the Code:

- (a) change the persons eligible to receive options;
- (b) except as provided in paragraph 3 hereof, increase the total number of Common Shares of the Company which may be made subject to options granted under this Plan;
- (c) except as provided in paragraph 3 hereof, change the minimum purchase price for the exercise of an option;
- (d) increase the maximum period during which options may be exercised or otherwise materially increase the benefits accruing to participants under this Plan; or
- (e) extend the term of this Plan beyond December 1, 2006.

No amendment to this Plan shall, without the consent of the holder of the option, alter or impair any options previously granted under this Plan.

16. EFFECTIVE DATE. This Plan shall be effective upon the Merger.

EXHIBIT 10(d)

RESTATED AND AMENDED NOTE PURCHASE AGREEMENT
BETWEEN THE COMPANY AND AETHERWORKS CORPORATION,
DATED OCTOBER 14, 1997

AETHERWORKS CORPORATION

1997 NOTE PURCHASE AGREEMENT

THIS AGREEMENT is made and entered into as of October 14, 1997 by and between AetherWorks Corporation, a Minnesota corporation (the "Company"), and Digi International Inc., a Delaware corporation ("Digi") sometimes referred to individually as a "Party" and collectively as the "Parties."

R E C I T A L S

As of October 10, 1995, the Company and Digi entered into a Note Purchase Agreement, providing for, among other things, the purchase by Digi of a Convertible Note of the Company dated October 10, 1995 in the principal amount of \$3,353,235. As provided in the Note Purchase Agreement of October 10, 1995, the Company and Digi also entered into, each as of October 10, 1995,

- (i) a Security Agreement,
- (ii) a Manufacturing Agreement, and
- (iii) a Shareholder Voting Agreement.

As of June 19, 1996, the Company and Digi entered into a Restated and Amended Note Purchase Agreement which amended and restated in its entirety the Note Purchase Agreement of October 10, 1995. The Restated and Amended Note Purchase Agreement of June 19, 1996 provided, among other things, for:

- (i) the amendment and restatement of the Convertible Note of October 10, 1995, into a Restated and Amended Convertible Note, also dated October 10, 1995, in the principal amount of \$3,363,235, (hereinafter referred to as the "Restated and Amended Convertible Note of October 10, 1995");
- (ii) the purchase by Digi of a Convertible Note of the Company dated June 20, 1996 in the principal amount of \$1,433,290 (hereinafter referred to as the "Convertible Note of June 20, 1996");
- (iii) on the terms and subject to the conditions of the Restated and Amended Note Purchase Agreement of June 19, 1996, the purchase by Digi of one or more additional notes in the form of the Convertible Note of June 20, 1996, up to the aggregate principal amount of \$9,000,000. (Such notes actually purchased by Digi, which have an aggregate principal of \$7,000,000 are hereinafter referred to as the "Additional Convertible Notes");
- (iv) a Restated and Amended Security Agreement, which amended and restated in its entirety, as of June 19, 1996, the Security Agreement of October 10, 1995;
- (v) a Restated and Amended Manufacturing Agreement, which amended and restated in its entirety, as of June 19, 1996, the Manufacturing Agreement of October 10, 1995;
- (vi) a Restated and Amended Shareholder Voting Agreement, which amended and restated in its entirety, as of June 19, 1996, the Shareholder Voting Agreement of October 10, 1995;
- (vii) a Technology Transfer Agreement, entered into June 19, 1996.

The Parties desire to rescind or further amend and restate such agreements and instruments as provided herein.

A G R E E M E N T

NOW, THEREFORE, in consideration of the foregoing premises and the Parties' respective rights and obligations set forth in this Agreement, the Company and Digi hereby agree as follows:

1. RESCISSION OF CERTAIN AGREEMENTS. All written or oral contracts, agreements and understandings between the Parties, EXCEPT FOR the Restated and Amended Agreements and Instruments (as defined in Section 2 below), are hereby rescinded and shall be of no further force or effect. (Such rescinded contracts, agreements and understandings are hereinafter referred to as the "Rescinded Agreements and Instruments.") Each Party (the "Releasing Party") hereby releases the other Party (the "Released Party") and each of the Released Party's officers, directors, shareholders, employees, consultants and agents (collectively "affiliates") from (i) all obligations of the Released Party and its affiliates under the Rescinded Agreements and Instruments and (ii) all actions, causes of action, suits, debts, obligations, losses, costs, claims, promises, damages and demands whatsoever, known or unknown, which the Releasing Party ever had, now has, or hereafter may have against the Released Party and its affiliates (except that such release shall not release or otherwise affect any obligation of the Released Party or its affiliates under this Agreement, the Restated and Amended Agreements and Instruments, or the Equipment Lease (as defined in Section 5.8 below.) The contracts, agreements and understandings between the Parties which are rescinded hereby include, without limitation, the Restated and Amended Note Purchase Agreement of June 19, 1996, the Restated and Amended Manufacturing Agreement of June 19, 1996, and the Technology Transfer Agreement of June 19, 1996.

2. RESTATEMENT AND AMENDMENT OF CERTAIN AGREEMENTS AND INSTRUMENTS. The following agreements and instruments (the "Restated and Amended Agreements and Instruments") shall be amended and restated as follows:

(a) the Restated and Amended Convertible Note of October 10, 1995, the Convertible Note of June 20, 1996 and the Additional Convertible Notes (collectively the "Outstanding Notes") shall be exchanged for, and are thereby amended and restated in their entirety by Note A (as defined in Section 3.1 below);

(b) the Restated and Amended Security Agreement of June 19, 1996 shall be amended and restated in its entirety by the 1997 Security Agreement (as defined in Section 3.3 below); and

(c) the Restated and Amended Shareholder Voting Agreement of June 19, 1996 shall be amended and restated in its entirety by the 1997 Shareholder Voting Agreement (as defined under Section 5.9 below).

3. NOTES.

3.1 NOTE A

(a) INITIAL PRINCIPAL AMOUNT. The Parties agree that, as of the date of this Agreement, the amount of the aggregate unpaid principal of the Outstanding Notes is \$11,796,525 (the "Initial Principal Amount"). On the terms and subject to the conditions of this Agreement, the Company agrees to issue to Digi, a note of the Company in the form of Exhibit 1 hereto and in a principal amount equal to the Initial Principal Amount, in consideration of, and in full satisfaction of, the Initial Principal Amount owed by the Company to Digi under the Outstanding Notes. (The Initial Principal Amount is subject to increase from time to time, as described in Section 3.1(b) below.) Such note, and any notes issued in exchange or in substitution therefor shall be referred to herein as "Note

A." The unpaid accrued interest on the Outstanding Notes as of the Closing Date (as defined in Section 4 below) will become additional principal of Note B (as defined in Section 3.2 (b) below).

(b) ADDITIONAL ADVANCES. At any time and from time to time after the date of this Agreement, but only before the earlier of (i) the Initial Public Offering (as defined in Section 3.4 below) or (ii) December 31, 1998, Digi shall lend to the Company at the Company's request additional amounts up to an aggregate amount of \$2,000,000, provided that in each case the conditions for an Additional Advance in Section 5 are satisfied. Each such additional loan shall be referred to herein as an "Additional Advance," and the \$2,000,000 maximum aggregate amount of such loans shall be referred to as the "Maximum Aggregate Advance." The Company shall be required to borrow the full amount of the Maximum Aggregate Advance prior to effecting any prepayment, however the Company shall have the right to specify the timing of such borrowings, subject to the provisions of this Section 3.1(b). Each such request by the Company shall (i) be in writing, (ii) specify the amount of the Additional Advance, and (iii) propose a funds transfer date (the "Additional Advance Date") which shall not be less than 10 days after receipt of such request by Digi, without Digi's consent to such reduced notice. Funds in the amount of the Additional Advance shall be transferred by Digi on the Additional Advance Date to the Company either by delivery to the Company of Digi's bank cashier's check drawn on Norwest Bank Minnesota National Association, or wire transfer of same-day funds. Upon receipt by the Company of funds transferred from Digi pursuant to a request for an Additional Advance, the principal amount of Note A shall be increased by the amount of such transferred funds, automatically and without any further action by the Company or by Digi.

(c) EQUIPMENT LEASE ADVANCES. Any failure by the Company to pay any amount when due under the Equipment Lease and upon the expiration of the ten-day grace period provided therein, shall constitute a request for an Additional Advance equal to such amount, and said amount shall immediately be added to the principal of Note A, unless the aggregate amount of such Additional Advance and all prior Additional Advances under Section 3.1(b) and this Section 3.1(c) would exceed the Maximum Aggregate Advance.

3.2 NOTE B

(a) INITIAL PRINCIPAL AMOUNT. On the terms of and subject to the conditions of this Agreement, the Company agrees to issue to Digi a note of the Company in the form of Exhibit 2, which note, and any notes issued in exchange or in substitution therefor, shall be referred to herein as "Note B." The initial principal amount of this Note shall be One Million Eight Hundred Two Thousand Six Hundred Twenty Six dollars (\$1,802,626) in consideration of, and in complete satisfaction of, the following amounts owed by the Company to Digi:

- (i) \$1,432,626 which the Parties agree is the amount of the aggregate unpaid accrued interest on the Outstanding Notes; and
- (ii) \$370,000, which is the amount agreed by the Parties to be paid to Digi in consideration of certain lease guarantees provided by Digi for the benefit of the Company from time to time prior to the date of this Agreement, and of the Equipment Lease.

The Initial Principal Amount is subject to increase from time to time, as described in Section 3.2(b) below.

(b) ADDITIONAL PRINCIPAL. As provided in Note A and Note B (each individually referred to hereinafter as a "Note" and together as the "Notes"), the principal amount of Note B shall be increased from time to time, automatically and without any action by the Company or Digi, as the accrued interest on Note A is converted into principal of Note B.

3.3 SECURITY AGREEMENT. The Company will grant a security interest to Digi in those assets of the Company identified in, and in accordance with the terms of, a Security

Agreement in the form of Exhibit 3 (the "1997 Security Agreement") between the Company and Digi to secure the Company's Obligations (as defined in the 1997 Security Agreement) to Digi.

3.4 INITIAL PUBLIC OFFERING. For all purposes under this Agreement, the term "Initial Public Offering" shall mean the closing of the first public offering of the Company of shares of Common Stock of the Company in which (i) the aggregate public offering price of the securities sold for cash by the Company in the offering is at least \$5,000,000 and (ii) the offering is underwritten on a firm commitment basis by an underwriter, or by a group of underwriters presented by an underwriter or underwriters, which is a member of a recognized stock exchange. Such offering must be conducted either (x) in the United States pursuant to an effective registration under the Securities Act of 1933, as amended (the "Securities Act"), or (y) outside the United States in full compliance with the laws and regulations applicable to public offerings in the jurisdiction in which the public offering is made and also in full compliance with the Securities Act to the extent applicable thereto. For purposes of this Section 3.4, the term "closing" shall mean the delivery by the Company to the underwriters of certificates representing the shares of Common Stock offered to the public against delivery to the Company by the underwriters of payment therefor, and the term "firm commitment basis" with respect to the underwriting of such public offering shall mean a commitment pursuant to a written underwriting agreement under which the nature of the underwriters' commitment is such that all securities will be purchased by such underwriters if any securities are purchased by such underwriters.

4. CLOSING. The closing (the "Closing") of the issuance of the Notes by the Company to Digi, shall occur at the offices of Digi at 3:30 p.m. on October 14, 1997, or on such other day or at such other time or place as Digi and the Company shall agree upon (the "Closing Date"). At the Closing, the Company will deliver to Digi the executed copies of the Notes, and Digi will deliver the Outstanding Notes to the Company for cancellation.

5. CONDITIONS TO CLOSING AND TO ADDITIONAL ADVANCES. Digi's obligations under this Agreement are subject to the fulfillment, prior to or on the Closing Date, of the conditions set forth in Sections 5.1 through 5.10, inclusive. Digi's obligations to make any Additional Advance requested by the Company under Section 3.1(b) above are subject to the fulfillment prior to or on the respective Additional Advance Date of the conditions set forth in Sections 5.1 through 5.5 below, inclusive.

5.1 NO ERRORS, ETC. The representations and warranties of the Company in Section 6 of this Agreement shall be true in all material respects on the Closing Date or on such Additional Advance Date, as the case may be, as if given as of such Closing Date or such Additional Advance Date, respectively.

5.2 COMPLIANCE WITH AGREEMENTS. The Company shall have performed and complied with all material agreements or conditions required by this Agreement, by the 1997 Security Agreement and the Equipment Lease, to be performed and complied with by it prior to or as of the Closing Date or the Additional Advance Date, as the case may be.

5.3 NO EVENT OF DEFAULT BY THE COMPANY. There shall exist at the time of the Closing, or of the Additional Advance Date, as the case may be, no condition or event which would constitute an Event of Default by the Company (as defined in Section 12 below) or which, after notice or lapse of time or both, would constitute an Event of Default.

5.4 CERTIFICATE OF OFFICERS.

(a) In the case of the Closing, the Company shall have delivered to Digi a certificate, dated the Closing Date, executed by the Chief Executive Officer and the Chief Financial Officer of the Company and certifying to the satisfaction of the conditions specified in Sections 5.1, 5.2 and 5.3 hereof.

(b) In the case of an Additional Advance, each such request by the Company, pursuant to Section 3.1(b) above, shall be signed by either the Chief Executive Officer or the Chief Financial Officer of the Company. Such request shall constitute, whether or not affirmatively acknowledged therein, a certification by such officer or other person making such request on behalf of the Company of the satisfaction of the conditions specified in Sections 5.1, 5.2 and 5.3 hereof.

5.5 QUALIFICATION UNDER STATE SECURITIES LAWS. All registrations, qualifications, permits and approvals required under applicable state securities laws for the lawful execution and delivery of this Agreement and the offer, sale, issuance and delivery of the Notes, any request for an Additional Advance, and the offer of the Conversion Stock (as defined in Section 6.1 below) shall have been obtained.

5.6 OPINION OF COUNSEL. As of the Closing Date, the Company shall have delivered to Digi an opinion or opinions of counsel for the Company in form acceptable to counsel for Digi.

5.7 1997 SECURITY AGREEMENT. Digi and the Company shall have entered into the 1997 Security Agreement.

5.8 EQUIPMENT LEASE. Digi and the Company shall have entered into the Equipment Lease in the form of Exhibit 4 (the "Equipment Lease").

5.9 1997 SHAREHOLDER VOTING AGREEMENT. Digi, William H. Costigan ("Costigan"), Robert C. Lind, Ph.D. ("Lind"), and Jonathan A. Henrikssen Sachs, Ph.D. ("Sachs"), shall have entered into a shareholder voting agreement in the form of Exhibit 5 (the "1997 Shareholder Voting Agreement").

5.10 CO-SALE AGREEMENT. Digi, Lind and Sachs shall have entered into a Co-Sale Agreement in the form of Exhibit 6 (the "Co-Sale Agreement").

6. REPRESENTATIONS AND WARRANTIES BY COMPANY. Except as disclosed in the disclosure schedule attached as Schedule A hereto (the "Disclosure Schedule"), the Company represents and warrants to Digi that:

6.1 ORGANIZATION, STANDING, ETC. The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of Minnesota, and has the requisite corporate power and authority to own its properties and to carry on its business in all material respects as it is now being conducted. The Company has the requisite corporate power and authority to issue the Notes and the shares of Common Stock into which Note A is convertible and all shares of Common Stock of the Company issued in exchange or substitution therefor (the "Conversion Stock"), and otherwise to perform its obligations under this Agreement, the Notes and the Ancillary Agreements. The copies of the Articles of Incorporation and Bylaws of the Company delivered to Digi or their agents prior to the execution of this Agreement are true and complete copies of the duly and legally adopted Articles of Incorporation and Bylaws of the Company in effect as of the date of this Agreement. As of the date of this Agreement, the Company does not have any direct or indirect equity interest in any other firm, corporation, partnership, joint venture association or other business organization.

6.2 QUALIFICATION. To the best of its knowledge, the Company is duly qualified or licensed as a foreign corporation in good standing in each jurisdiction wherein the nature of its activities or of its properties owned or leased makes such qualification or licensing necessary, and failure to be so qualified or licensed would have a material adverse impact on its business.

6.3 COMPLIANCE WITH APPLICABLE LAWS AND OTHER INSTRUMENTS. To the best of the Company's knowledge, neither the execution nor delivery of, nor the performance of or

compliance with this Agreement, the Notes or the Ancillary Agreements nor the consummation of the transactions contemplated hereby or thereby will conflict with, or, with or without the giving of notice or passage of time, result in any breach of, or constitute a default under, or result in the imposition of any lien or encumbrance upon any asset or property of the Company pursuant to, any applicable law, administrative regulation or judgment, order or decree of any court or governmental body, any agreement or other instrument to which the Company is a party or by which it or any of its properties, assets or rights is bound or affected, and will not violate the Articles of Incorporation or Bylaws of the Company; the Company is not in violation of its Articles of Incorporation or its Bylaws nor in violation of, or in default under, any lien, indenture, mortgage, lease, agreement, instrument, commitment or arrangement in any material respect other than as otherwise disclosed herein.

6.4 CAPITAL STOCK. The authorized capital stock of the Company consists of 10,000,000 common shares, of which 1,200,409 shares are issued and outstanding; all of these shares were duly authorized, validly issued and are fully paid and nonassessable. In addition, there are outstanding warrants to purchase 44,864 common shares and outstanding options to purchase 205,063 common shares. Other than the foregoing and Note A, there are no outstanding subscriptions, options, warrants, calls, contracts, demands, commitments, or other securities which are at any time directly or indirectly convertible or exchangeable for shares of common stock of the Company or other agreements or arrangements of any character or nature whatever, except as otherwise disclosed in the Disclosure Schedule or as contemplated by this Agreement, under which the Company is or may be obligated to issue capital stock or other securities of any kind representing an ownership interest or contingent ownership interest in the Company. Neither the offer nor the issuance or sale of the Notes or the Conversion Stock constitutes an event, under any anti-dilution provisions of any securities issued or issuable by the Company or any agreements with respect to the issuance of securities by the Company, which will either increase the number of shares issuable pursuant to such provisions or decrease the consideration per share to be received by the Company pursuant to such provisions. No holder of any security of the Company is entitled to any preemptive or similar rights to purchase securities from the Company except as otherwise contemplated by this Agreement, provided, however, that nothing in this Section 6.4 shall affect, alter or diminish any right granted to Digi in this Agreement. To the best of Company's knowledge, all outstanding securities of the Company have been issued in full compliance with an exemption or exemptions from the registration and prospectus delivery requirements of the Securities Act and from the registration and qualification requirements of all applicable state securities laws.

6.5 CONVERSION STOCK. The Conversion Stock has been reserved for issuance, and when issued upon conversion will be duly authorized, validly issued and outstanding, fully paid, nonassessable and free and clear of all pledges, liens, encumbrances and restrictions, except for those imposed by this Agreement. The certificates representing the Conversion Stock to be delivered upon the conversion of Note A will be genuine, and the Company has no knowledge of any fact which would impair the validity thereof.

6.6 SECURITIES LAWS. Based in part upon the representations and warranties contained in Section 7 hereof and the advice of the Company's counsel, no consent, authorization, approval, permit or order of or filing with any governmental or regulatory authority is required under current laws and regulations in connection with the execution and delivery of this Agreement or the Ancillary Documents or the offer, issuance, sale or delivery of the Notes or the offer of the Conversion Stock other than the qualification thereof, if required, under applicable state securities laws, which qualification has been or will be effected its it condition of these sales. The Company has not, directly or through an agent, offered the Notes or the Conversion Stock, or any similar securities for sale to, or solicited any offers to acquire such securities from, persons other than Digi. Based on the advice of the Company's counsel, under the circumstances contemplated hereby, the offer, issuance, sale and delivery of the Notes and the offer of the Conversion Stock will not under current laws and regulations require compliance with the prospectus delivery or registration requirements of the Securities Act.

6.7 CORPORATE ACTS AND PROCEEDINGS. This Agreement has been duly authorized by all necessary corporate action on behalf of the Company, and has been duly executed

and delivered by authorized officers of the Company. All corporate action necessary to the authorization, creation, issuance and delivery of the Notes, the Conversion Stock, this Agreement and the Ancillary Agreements has been taken on the part of the Company, or will be taken by the Company on or prior to the Closing Date. This Agreement is, and each of the Notes when issued pursuant to the terms of this Agreement will be, and the Ancillary Agreements when executed and delivered pursuant to the terms of this Agreement will be, a valid and binding agreement of the Company enforceable in accordance with its terms, except as the enforceability thereof may be limited by bankruptcy, insolvency, moratorium, reorganization or other similar laws affecting the enforcement of creditors' rights generally, and except for judicial limitations on the enforcement of the remedy of specific enforcement and other equitable remedies.

6.8 NO BROKERS OR FINDERS. No person, firm or corporation has or will have, as a result of any act or omission by the Company, any right, interest or valid claim against or upon the Company or Digi for any commission, fee or other compensation as a finder or broker, or in any similar capacity, in connection with the transactions contemplated by this Agreement. The Company will indemnify and hold Digi harmless against any and all liability with respect to any such commission, fee or other compensation which may be payable or determined to be payable as a result of the actions of the Company in connection with the transactions contemplated by this Agreement.

6.9 GUARANTEED INDEBTEDNESS. Schedule A includes a complete and correct list of all indebtedness, leases and other liabilities and obligations of the Company which are directly or indirectly guaranteed by Digi, or in respect of which Digi is otherwise directly or indirectly liable, contingent or otherwise, including, without limitation, any such liability or obligation in effect guaranteed by Digi through any agreement (contingent or otherwise) to make payment for any products, materials or supplies (collectively, the "Guaranteed Indebtedness") as of the date of this Agreement. Schedule A also sets forth in dollar amounts the maximum exposure of Digi for the Guaranteed Indebtedness as of the date of this Agreement.

6.10 LITIGATION. There are no legal actions, suits, arbitrations or other legal, administrative or governmental proceedings or investigations pending or, to the knowledge of the Company, threatened against the Company, its properties, assets or business, and the Company is not aware of any facts which are likely to result in or form the basis for any such action, suit or other proceeding, except as disclosed in Schedule A. The Company is not in default with respect to any judgment, order or decree of any court or any governmental agency or instrumentality. The Company has not been threatened with any action or proceeding under any business or zoning ordinance, law or regulation.

6.11 DISCLOSURE. The Company has not withheld from Digi any material facts relating to the assets, business, operations, financial condition or prospects of the Company. No representation or warranty in this Agreement or in any certificate, schedule, written statement or other document furnished to Digi pursuant hereto or in connection with the transactions contemplated hereby contains any untrue statement of a material fact or omits to state any material fact required to be stated herein or therein or necessary to make the statements herein or therein not misleading. The Company has regularly disclosed to Digi all material facts regarding its negotiations with Cabletron, AT&T Venture Capital, St. Paul Venture Capital, and AT&T

7. REPRESENTATIONS AND WARRANTIES OF DIGI. Digi represents and warrants that:

7.1 INVESTMENT INTENT. The Notes being acquired and to be acquired by Digi hereunder are being purchased or will be purchased, and the Conversion Stock acquired by Digi upon conversion of Note A will be acquired, for Digi's own account and not with the view to, or for resale in connection with, any distribution or public offering thereof within the meaning of the Securities Act. Digi understands that Note A and the Conversion Stock have not been registered under the Securities Act or any applicable state laws, by reason of their issuance or contemplated issuance in a transaction exempt from the registration and prospectus delivery requirements of the Securities Act and such laws, and that the reliance of the Company upon this exemption is predicated in part upon this representation and warranty. Digi further understands that the Notes

and Conversion Stock may not be transferred or resold without (a) registration under the Securities Act and any applicable state securities laws, or (b) an exemption from the requirements of the Securities Act and applicable state securities laws.

Digi understands that an exemption from such registration is not presently available pursuant to Rule 144 promulgated under the Securities Act by the Securities and Exchange Commission (the "Commission") and that in any event Digi may not sell any securities pursuant to Rule 144 prior to the expiration of a one-year period after Digi has acquired the securities. Digi understands that any sales pursuant to Rule 144 may only be made in full compliance with the provisions of Rule 144.

7.2 LOCATION OF PRINCIPAL OFFICE AND QUALIFICATION AS ACCREDITED INVESTOR. Digi's principal office is located in Minnetonka, Minnesota. Digi qualifies as an accredited investor within the meaning of Rule 501 under the Securities Act. Digi has such knowledge and experience in financial and business matters that Digi is capable of evaluating the merits and risks of the investment to be made hereunder by Digi.

7.3 ACCESS TO INFORMATION. Digi has and has had access to all of the Company's material books and records, and access to the Company's executive officers has been regularly provided to Digi or to Digi's agents. Two persons designated by Digi have been members of the Company's Board of Directors since October 1995. These representatives participated in the consideration and approval of the Company's business plan dated August 1996 and in the consideration and approval of the AetherWorks August 7, 1997 Business Plan. The Company has regularly provided Digi with full and ample opportunity to ask questions of representatives of the Company on all matters pertaining to the Company's operations and business plans, including its current negotiations with Cabletron, AT&T Venture Capital, St. Paul Venture Capital, and AT&T. Officers and representatives of the Company have made themselves available to Digi upon request.

7.4 CORPORATE ACTS AND PROCEEDINGS. This Agreement has been duly authorized by all necessary corporate action on behalf of Digi, and has been duly executed and delivered by authorized officers of Digi. All corporate action necessary to the authorization, and delivery of this Agreement has been taken on the part of Digi, or will be taken by Digi on or prior to the Closing. This Agreement is, and when executed and delivered pursuant to the terms of this Agreement will be, a valid and binding agreement of Digi, enforceable in accordance with its terms, except as the enforceability thereof may be limited by bankruptcy, insolvency, moratorium, reorganization or other similar laws affecting the enforcement of creditors' rights generally, and except for judicial limitations on the enforcement of the remedy of specific enforcement and other equitable remedies.

7.5 NO BROKERS OR FINDERS. No person, firm or corporation has or will have, as a result of any act or omission by Digi, any right, interest or valid claim against the Company or Digi for any commission, fee or other compensation as a finder or broker, or in any similar capacity, in connection with the transactions contemplated by this Agreement. Digi will indemnify and hold the Company harmless against any and all liability with respect to any such commission, fee or other compensation which may be payable or determined to be payable as a result of the actions of Digi in connection with the transactions contemplated by this Agreement.

8. AFFIRMATIVE COVENANTS. The Company covenants and agrees that:

8.1 GUARANTEED INDEBTEDNESS. The Company acknowledges and agrees that Digi:

(a) shall maintain all its guarantees on all Guaranteed Indebtedness existing as of this Agreement, but may notify all creditors, lessors and other parties, which hold any rights under any Guaranteed Indebtedness that Digi will not guarantee, and prospectively revokes any guarantee by Digi of, any indebtedness, leases or other liabilities or obligations of the Company created after the date of this Agreement; and

(b) shall, upon payment or other satisfaction of Guaranteed Indebtedness by Digi have rights of reimbursement, subrogation and exoneration against the Company therefor. These rights shall be in addition to Digi's rights under Section 8.4 below. By way of specifying certain of Digi's rights and not by way of limitation, the Company shall immediately reimburse Digi for any such payment or the amount of any such satisfaction plus the incidental costs to Digi of such payment or satisfaction.

8.2 PREEMPTIVE RIGHTS.

(a) OBLIGATION TO OFFER. Until the Initial Public Offering, if the Company should decide to issue and sell additional shares of any capital stock of the Company or any warrants, securities convertible into capital stock of the Company or other rights to subscribe for or to purchase any capital stock of the Company, other than (i) shares of Common Stock awarded or issued upon the exercise of options granted pursuant to employee and consultant benefit plans adopted by the Company, and the grant of such options themselves, provided that the aggregate number of shares thus awarded and issued and issuable pursuant to the exercise of all such options shall not be in excess of 600,534 (appropriately adjusted to reflect stock splits, stock dividends, reorganizations, consolidations and similar changes effected after the date of this Agreement), (ii) previously-issued warrants for 44,864 shares of Common Stock; and (iii) Conversion Stock issued upon conversion of Note A (all such capital stock, warrants, securities convertible into capital stock and other rights, other than securities referred to in clauses (i) and (ii) above, being hereinafter sometimes collectively referred to as "Additional Securities"), the Company shall first offer to sell to Digi, the same type of securities, at the same price, and with the same payment and other financial terms, and with the same registration rights, co-sale rights and rights of first refusal (if any) as the Company is proposing to issue and sell such Additional Securities to others, Digi's pro rata share (as defined below) of such Additional Securities. Such offer shall be made by written notice given to Digi and specifying therein the number of the Additional Securities being offered, and the purchase price and other terms of such offer. Digi shall have a period of 21 calendar days from and after the date of receipt by it of such notice within which to accept such offer. Failure by Digi to respond within such 21-day period shall be deemed to be a declination of Digi's rights. If Digi elects to accept such offer in whole or in part, Digi shall so accept by written notice received by the Company within such 21-day period. If Digi fails to accept such offer in whole or in part within such 21-day period, any of such Additional Securities not purchased by Digi pursuant to such offer may be offered for sale to others by the Company for a period of 60 days from the last day of such 21-day period, but only on the same terms and conditions as set forth in the initial offer to Digi, free and clear of the restrictions imposed by this Section 8.2.

(b) PRO RATA SHARE. For purposes of Section 8.2(a) above, Digi's "pro rata share" is the number of shares of Additional Securities (rounded to the nearest whole share) as is equal to the product of (a) which is (i) the total number of shares of Common Stock held by Digi and issuable to Digi upon the conversion of the then-outstanding principal balance on Note A held by Digi immediately prior to the issuance of the Additional Securities being offered (the shares issuable upon such conversion being the "Conversion Shares"), divided by (ii) the sum of (x), the total number of shares of Common Stock of the Company outstanding immediately prior to the issuance of the Additional Securities plus (y) the Conversion Shares, and (b) the entire number of Additional Securities being offered.

8.3 V.MACH AND ARM 1 PROFIT SHARING.

(a) SHARE OF PROFITS. The Company and Digi shall share equally in all Profits (as defined in Section 8.3(b) below) of the Company from the V. Mach Technology or the ARM-1 Device (each as defined in Section 8.3(b) below).

(b) Definitions

(i) "Profits" shall mean (A) all revenues (whether received in the form of royalties, license fees or some other form, and whether received in the form of cash or some

other form of consideration) of the Company from any and all licenses, sublicenses, leases, sales or other transfers by the Company of the V. Mach Technology or the ARM-1 Device to third parties, other than licenses, sublicenses, leases, sales or transfers which are a necessary component of ordinary-course commercial sales by the Company of the ARM-1 Device or of products based on the V.Mach Technology directly to end users of the said technology, or the ARM-1 Device minus (B) all directly-associated expenses of the Company of such license, sublicense, sale, lease or transfer which are incurred after the date of this Agreement, including royalty obligations of the Company with respect to such technology which are existing as of the date of this Agreement but excluding any additional royalty obligations incurred after the date of this Agreement.

(ii) The "V.Mach Technology" shall mean the modern transmission technology which is more particularly described in the Letter Agreement dated 7 May 1996 among the Company, BeKo Telekommunikation u Nachrichtentechnik GmbH ("BeKo"), Mr. Thomas Beck ("Beck"), and Professor Dr. Dmitrij Korobkow ("Korobkow") (the "BeKo Agreement"), subject only to those pre-existing interests of BeKo and certain third parties identified in the BeKo Agreement, and shall include, without limitation, (i) any physical manifestation of the V.Mach Technology, including production and prototype modems and other communication equipment, or any electronic rendering thereof, (ii) any physical or electronic documentation pertaining to the V.Mach Technology, including source code, object code, notes, flow charts, formulae, logic diagrams, drawings, reports, printouts and other documentation, whether recorded on paper or electronically, and (iii) rights in connection with or arising from V.Mach Technology, including the V.Mach mark, trade secrets, inventions, improvements and ideas, whether or not patentable, know-how, and material protected by copyright.

(iii) The ARM-1 Device shall mean the device based on the Rockwell chipset RC32ACM, dedicated to Mobitex service and to 14.4 kbps data transmission on telephone lines, and shall, include, (i) any physical manifestation of the ARM-1 Device, including production and prototype devices, or any electronic rendering thereof, (ii) any physical or electronic documentation pertaining to the ARM-1 Device, including source code, object code, notes, flow charts, formulae, logic diagrams, drawings, reports, printouts and other documentation, whether recorded on paper or electronically, and (iii) rights in connection with or arising from the ARM-1 device, including any trademarks, trade secrets, inventions, improvements and ideas, whether or not patentable, know-how, and material protected by copyright.

(c) PAYMENT; AUDIT. Digi's share of Profits described in Section 8.3(a) above shall be remitted immediately to Digi upon receipt of payment thereof by the Company. With each such remittance, the Company shall provide Digi with a reasonably detailed calculation and description of such revenue share. The Company shall, upon written request by Digi, during normal business hours, provide reasonable access to the Company's accounting records that support and document the payments to be made in connection with this Section 8.3 by an independent accounting firm chosen and compensated by Digi, for purposes of audit. Such accounting firm shall be required to sign a non-disclosure agreement acceptable to the Company and shall be authorized to report only the amounts of the share of Profits due and payable for the period requested. If underpayment is greater than five percent (5%) of the amounts due, the Company shall pay the (i) the amount of such shortfall plus (ii) the reasonable accounting fees and expenses incurred in connection with such audit.

8.4 INDEMNIFICATION. The Company hereby agrees to defend, indemnify and hold harmless Digi against and with respect to:

(a) any and all liabilities and obligations arising from or in connection with any and all agreements, contracts or understandings between the Company and any or all of BeKo, Beck, Korobkow, and any stockholder of BeKo, including the BeKo Agreement, and including any liabilities or obligations arising in connection with any disputes or litigation relating to the foregoing, whether or not readily apparent on or prior to the date of this Agreement;

(b) any and all Guaranteed Indebtedness whether arising before or after the date of this Agreement; and

(c) any and all demands, claims, actions, suits, proceedings, assessments, judgments, costs and legal and other expenses incident to any of the foregoing.

In the event any demands or claims are asserted against Digi or any actions, suits or proceedings are commenced against Digi for which the Company is obligated to indemnify Digi under this Section 8.4, then Digi shall give timely notice thereof to the Company; but the omission so to notify the Company will not relieve it from any liability which it may have to Digi hereunder, so long as this failure to provide notice does not substantially prejudice the interests of Company. Upon such notice, the Company shall have the right to participate in, and, to the extent that it may wish, jointly with Digi, assume the defense thereof, with counsel chosen by the Company and satisfactory to Digi; PROVIDED, HOWEVER, if Digi in any action including both the Digi and the Company shall reasonably conclude that there are legal defenses available to Digi which are different from or additional to those available to the Company, or if there is a conflict of interest which would prevent counsel for the Company from also representing Digi, Digi shall have the right to select and be represented by separate counsel reasonably satisfactory to Company. For these purposes Faegre & Benson LLP shall be deemed to be satisfactory to the Company. After notice from the Company to Digi of its election to assume the defense thereof, the Company will not be liable to Digi for any legal or other expense subsequently incurred by Digi in connection with the defense thereof other than reasonable costs of investigation and cooperation, unless (i) Digi shall have employed counsel in accordance with the proviso of the preceding sentence, (ii) the Company shall not have employed counsel satisfactory to Digi to represent Digi within a reasonable time after the notice of the demand or claim or the commencement of such action suit or proceeding or (iii) the Company has authorized the employment of counsel for the Digi at the expense of the Company.

8.5 BOARD OF DIRECTORS

(a) The Company agrees to submit to its shareholders and its Board of Directors as nominees for election as directors, and in filling interim vacancies on the Board of Directors of the Company, persons designated by Digi, and to solicit votes for such persons in the same manner and to the same degree as votes are solicited for other nominees for election, in the following numbers and during the following periods:

(i) Until the first to occur of an Initial Public Offering, December 31, 2000, or payment in full of the Notes and the Equipment Lease:

(A) so long as the total number of shares of Common Stock held by Digi and issuable to Digi upon the conversion of the then-outstanding principal balance of Note A (the Conversion Shares) equals or exceeds 25% of the outstanding shares of Common Stock of the Company (including the Conversion Shares), Digi shall be entitled to designate two directors of the Company and to exercise any right of removal or replacement of any such director, and

(B) so long as the total number of shares of Common Stock held by Digi and issuable to Digi upon the conversion the then-outstanding principal balance of Note A (the Conversion Shares) are less than 25% of the outstanding shares of Common Stock of the Company (including the Conversion Shares) then Digi shall be entitled to designate one director of the Company and to exercise any right of removal or replacement of any such director.

(ii) After the first to occur of an Initial Public Offering, December 31, 2000, or payment in full of the Notes and the Equipment Lease, and for so long as the total number of shares of Common Stock and conversion stock issuable upon conversion of Note A continuously held by Digi equals or exceeds 19% of the outstanding shares of Common Stock of the Company, then Digi shall be entitled to designate one director of the

Company and to exercise any right of removal or replacement of any such director.

(b) The Company shall reimburse all directors for the reasonable out-of-pocket expenses incurred by them in connection with the attending of meetings or carrying out any other duties that may be specified by the Board of Directors; shall maintain at all times, director and officer liability insurance in an amount of not less than \$1 million from a carrier reasonably acceptable to the Board of Directors of the Company; and shall maintain as part of its Articles of Incorporation or Bylaws a provision for the indemnification of its directors to the full extent permitted by law.

8.6 PUBLIC ANNOUNCEMENTS. Subject to applicable law, any public announcement by either Party relating to this Agreement and the transactions contemplated hereby shall, prior to its release, be submitted to the other Party for review and comment a reasonable time prior to such release (for which purposes two full business days shall in all cases be deemed reasonable); provided, however, that, subject only to providing the other Party such opportunity to review and comment, each Party shall retain the right and authority in its sole discretion to make any such release which it deems appropriate.

8.7 CORPORATE EXISTENCE. The Company will maintain its corporate existence in good standing and comply with all applicable laws and regulations of the United States or of any state or states thereof or of any political subdivision thereof and of any governmental authority where failure to so comply would have a material adverse impact on the Company or its business or operations.

8.8 BOOKS OF ACCOUNT AND RESERVES. The Company will keep books of record and account in which full, true and correct entries are made of all of its and their respective dealings, business and affairs, in accordance with generally accepted accounting principles. The Company will employ certified public accountants selected by the Board of Directors of the Company who are "independent" within the meaning of the accounting regulations of the Securities and Exchange Commission, and have recognized national standing, and have annual audits made by such independent public accountants in the course of which such accountants shall make such examinations, in accordance with generally accepted auditing standards, as will enable them to give such reports or opinions with respect to the financial statements of the Company as will satisfy the requirements of the Commission in effect at such time with respect to certificates and opinions of accountants.

8.9 FURNISHING OF FINANCIAL STATEMENTS AND INFORMATION. The Company will deliver to Digi:

(a) as soon as practicable, but in any event within 30 days after the close of each quarter of each fiscal year, unaudited consolidated balance sheets of the Company as of the end of such quarter, together with the related consolidated statements of operations and cash flow for such quarter, all in reasonable detail and certified by the principal accounting officer of the Company; and

(b) as soon as practicable, but in any event within 90 days after the end of each fiscal year, a consolidated balance sheet of the Company as of the end of such fiscal year, together with the related consolidated statements of operations, shareholders' equity and cash flow for such fiscal year, all in reasonable detail and duly certified by the Company's independent public accountants, which accountants shall have given the Company an opinion, unqualified as to the scope of the audit, regarding such statements, provided that the audit may contain a qualification regarding the Company's ability to continue as a going concern or any other generally accepted qualifications for a similar ongoing concern.

(c) concurrently with the delivery in each year of the financial statements referred to in paragraph (b) of this Section 8.9, a statement and report signed by the independent public accountants who certified such financial statements, to the effect that they have read this Agreement and that in the course of the audit upon which their certificate was based, they became aware of no

condition or event which constituted an Event of Default (as defined in Section 12 below) or which, after notice or lapse of time or both, would constitute an Event of Default, or if such accountants did become aware of any such condition or event, specifying the nature and period of existence thereof

8.10 RESERVATION OF SHARES; REPLACEMENT OF NOTES OR CERTIFICATES REPRESENTING CONVERSION STOCK.

(a) The Company shall at all times have authorized and reserved a sufficient number of shares of its Common Stock for the purpose of issue upon the conversion of Note A.

(b) Upon receipt of evidence reasonably satisfactory to the Company of the loss, theft, destruction or mutilation of any Notes or certificates representing Conversion Stock, and, in the case of any such loss, theft or destruction, upon delivery of a bond of indemnity satisfactory to the Company, or, in the case of any such mutilation, upon surrender and cancellation of the Notes or certificates representing Conversion Stock, as the case may be, the Company will issue replacement Notes or certificates representing Conversion Stock of like tenor, in lieu of such lost, stolen, destroyed or mutilated Notes or certificates representing Conversion Stock.

8.11 FILING OF REPORTS. The Company will, from and after such time as it has securities registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended, or has securities registered pursuant to the Securities Act, make timely filing of such reports as are required to be filed by it with the Commission so that Rule 144 under the Securities Act or any successor provision thereto will be available to the security holders of the Company who are otherwise able to take advantage of the provisions of such Rule.

8.12 RULE 144A. The Company agrees that, upon Digi's request, the Company shall promptly provide (but in any case within 15 days of receipt of a request) to Digi the following information: (a) a brief statement of the nature of the business of the Company and the products and services it offers; (b) the Company's most recent consolidated balance sheets and profit and loss and retained earnings statements, and similar financial statements for such part of the two preceding fiscal years prior to such request as the Company has been in operation (such financial information shall be audited, to the extent reasonably available); and (c) such other information about the Company and its business, financial condition and results of operations as the requesting person shall specify in order to comply with Rule 144A promulgated under the Securities Act and the anti-fraud provisions of the federal and state securities laws. The Company hereby represents and warrants to any such requesting person that the information provided by the Company pursuant to this Section 8.12 will not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

9. NEGATIVE COVENANTS. The Company agrees and covenants to be limited and restricted as follows:

9.1 GUARANTEED INDEBTEDNESS. The Company will not create or take any action that would, directly or indirectly, cause to be created any Guaranteed Indebtedness after the date of this Agreement. The Company shall not amend, extend, renew, change or modify any of the Guaranteed Indebtedness existing as of the date of this Agreement without the prior written consent of Digi; PROVIDED, HOWEVER, that

(i) the Company may prepay any Guaranteed Indebtedness, in whole or in part, without the consent of Digi and

(ii) with respect to any of the Guaranteed Indebtedness that relates to the leasing of equipment, the Company may substitute other equipment for the equipment originally leased, in its discretion, without

the prior written consent of Digi to the extent that the annual rental value/price of any individual piece of substituted equipment does not exceed the annual rental value/price for the original equipment by more than \$15,000 or 5%, whichever is less, and that any such substitution together with all other substitutions shall not cause the total annual rental amount of the agreement to increase in the aggregate by more than the lesser of \$25,000 or 5%.

9.2 DIVIDENDS ON OR REDEMPTION OF CAPITAL STOCK. Prior to the Initial Public Offering, or December 31, 1998, whichever shall first occur, without the prior approval of Digi, the Company will not declare or pay any dividend or make any other distribution on any shares of capital stock, or purchase, redeem or otherwise acquire for any consideration, or set aside a sinking fund or other fund for the redemption or repurchase of any shares of capital stock or any warrants, rights or options to purchase shares of capital stock; provided however that the Company may prepay the Notes in accordance with the terms thereof.

9.3 OTHER RESTRICTIONS. The Company will not without the prior approval of the Company's Board of Directors:

(a) guarantee, endorse or otherwise be or become contingently liable in connection with the obligations, securities or dividends of any person, firm, association or corporation, other than endorse negotiable instruments for collection in the ordinary course of business; or

(b) make loans or advances to any person (including without limitation to any officer, director or shareholder of the Company), firm, association or corporation, except loans and advances to the Company and advances to suppliers and employees made in the ordinary course of business; or

(c) purchase or invest in the stock or obligations of any other person, firm or corporation; or

(d) pay compensation, whether by way of salaries, bonuses, participations in pension or profit sharing plans, fees under management contracts or for professional services or fringe benefits to any officer in excess of amounts fixed by the Board of Directors of the Company prior to any payment to such officer;

10. RESTRICTION ON TRANSFER OF SECURITIES.

10.1 RESTRICTIONS. The Notes and the Conversion Stock are transferable only pursuant to (a) a public offering registered under the Securities Act, (b) Rule 144 (or any similar rule then in effect) adopted under the Securities Act, if such rule is available, and (c) subject to the conditions elsewhere specified in this Section 10, any other legally available means of transfer.

10.2 LEGEND.

(a) Notes. Each Note shall be endorsed with the following legend:

"The securities evidenced hereby may not be transferred without (i) the opinion of counsel satisfactory to the Company that such transfer may be lawfully made without registration under the Federal Securities Act of 1933 and all applicable state securities laws or (ii) such registration."

(b) Certificates. Upon the conversion of Note A unless the Company receives an opinion of counsel from Digi satisfactory to the Company to the effect that a sale, transfer, assignment, pledge or distribution of the Conversion Stock issuable upon such conversion may be made without registration, or unless such Conversion Stock is being disposed of pursuant to registration under the Securities Act and any applicable state act, the same legend shall be endorsed on the certificate

evidencing such Conversion Stock.

10.3 STOP TRANSFER ORDER. A stop transfer order shall be placed with the Company's transfer agent preventing transfer of any of the securities subject to the legend referred to in Section 10.2 above pending compliance with the conditions set forth in any such legend.

10.4 REMOVAL OF LEGEND. Any legend endorsed on a certificate or instrument evidencing a security pursuant to Section 10.2 hereof shall be removed, and the Company shall issue a certificate or instrument without such legend to Digi, if such security is being disposed of pursuant to registration under the Securities Act and any applicable state acts or pursuant to Rule 144 or any similar rule then in effect, or if Digi provides the Company with an opinion of counsel satisfactory to the Company to the effect that a sale, transfer, assignment, offer, pledge or distribution for value of such security may be made without registration and that such legend is not required to satisfy the applicable exemption from registration.

11. REGISTRATION OF SECURITIES

11.1 DIGI DEMAND FOR REGISTRATION If the Company shall receive a written request therefor from Digi after any initial public offering by the Company but prior to December 31, 2002, the Company shall prepare and file a registration statement under the Securities Act covering the Conversion Stock which is the subject of such request, and shall use its best efforts to cause such registration statement to become effective. The Company shall be obligated to prepare, file and cause to become effective only one registration statement (other than on Form S-3 or any successor form promulgated by the Commission ["Form S-3"]) pursuant to this Section 11.1, and to pay the expenses associated with such registration statements; notwithstanding the foregoing, Digi may require, pursuant to this Section 11.1, the Company to file and to pay the expenses associated with, up to three registration statements on Form S-3, if such form is then available for use by the Company and such record holder or holders. In the event that Digi determines for any reason not to proceed with a registration at any time before a registration statement has been declared effective by the Commission, and such registration statement, if theretofore filed with the Commission, is withdrawn with respect to the Conversion Stock covered thereby, and Digi agrees to bear its own expenses incurred in connection therewith and to reimburse the Company for the expenses incurred by it attributable to the registration of such Conversion Stock, then Digi shall not be deemed to have exercised its right to require the Company to register Conversion Stock pursuant to this Section 11.1.

If, at the time any written request for registration is received by the Company pursuant to this Section 11.1, the Company has determined to proceed with the actual preparation and filing of a registration statement under the Securities Act in connection with the proposed offer and sale for cash of any of its securities by it or any of its security holders, such written request shall be deemed to have been given pursuant to Section 11.2 hereof rather than this Section 11.1, and the rights of Digi covered by such written request shall be governed by Section 11.2 hereof.

11.2 INCIDENTAL REGISTRATION. Prior to December 31, 2002, each time the Company shall determine to proceed with the actual preparation and filing of a registration statement under the Securities Act in connection with the proposed offer and sale for cash of any of its securities by it or any of its security holders (other than a registration statement on a form that does not permit the inclusion of shares by its security holders), the Company will give written notice of its determination to Digi. Upon the written request of Digi given within 30 days after receipt of any such notice from the Company, the Company will, except as herein provided, cause all Conversion Stock for which Digi has requested registration to be included in such registration statement, all to the extent requisite to permit the sale or other disposition by Digi of such Conversion Stock; provided, however, that nothing herein shall prevent the Company from, at any time, abandoning or delaying any such registration initiated by it. If any registration pursuant to this Section 11.2 shall be underwritten in whole or in part, the Company may require that the Conversion Stock requested for inclusion pursuant to this Section 11.2 be included in the underwriting on the same terms and conditions as the securities otherwise being sold through the underwriters. If in the good faith judgment of the managing underwriter of such public offering the

inclusion of all or any portion of the Conversion Stock originally covered by a request for registration would reduce the number of shares to be offered by the Company or interfere with the successful marketing of the shares of stock offered by the Company, the number of Conversion Stock otherwise to be included in the underwritten public offering may be reduced. Conversion Stock which is thus excluded from the underwritten public offering shall be withheld from the market by Digi for a period of up to 90 days, which the managing underwriter reasonably determines is necessary in order to effect the underwritten public offering.

11.3 REGISTRATION PROCEDURES. If and whenever the Company is required by the provisions of Sections 11.1 and 11.2 hereof to effect the registration of Conversion Stock under the Securities Act, the Company will:

(a) prepare and file with the Commission a registration statement with respect to such securities, and use its best efforts to cause such registration statement to become and remain effective for such period as may be reasonably necessary to effect the sale of such securities, not to exceed nine months;

(b) prepare and file with the Commission such amendments to such registration statement and supplements to the prospectus contained therein as may be necessary to keep such registration statement effective for such period as may be reasonably necessary to effect the sale of such securities, not to exceed nine months;

(c) furnish to Digi and to the underwriters of the securities being registered such reasonable number of copies of the registration statement, preliminary prospectus, final prospectus and such other documents as such underwriters may reasonably request in order to facilitate the public offering of such securities;

(d) use its best efforts to register or qualify the securities covered by such registration statement under such state securities or blue sky laws of such jurisdictions as Digi may reasonably request in writing within 20 days following the original filing of such registration statement, except that the Company shall not for any purpose be required to execute a general consent to service of process or to qualify to do business as a foreign corporation in any jurisdiction wherein it is not so qualified;

(e) notify Digi, promptly after it shall receive notice thereof, of the time when such registration statement has become effective or a supplement to any prospectus forming a part of such registration statement has been filed;

(f) notify Digi promptly of any request by the Commission for the amending or supplementing of such registration statement or prospectus or for additional information;

(g) prepare and file with the Commission, promptly upon the request of Digi, any amendments or supplements to such registration statement or prospectus which, in the opinion of counsel for Digi (and concurred in by counsel for the Company), is required under the Securities Act or the rules and regulations thereunder in connection with the distribution of the Conversion Stock by Digi;

(h) prepare and promptly file with the Commission and promptly notify Digi of the filing of such amendment or supplement to such registration statement or prospectus as may be necessary to correct any statements or omissions if, at the time when a prospectus relating to such securities is required to be delivered under the Securities Act, any event shall have occurred as the result of which any such prospectus or any other prospectus as then in effect would include an untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in the light of the circumstances in which they were made, not misleading;

(i) advise Digi, promptly after it shall receive notice or obtain knowledge thereof, of the issuance of any stop order by the Commission suspending the

effectiveness of such registration statement or the initiation or threatening of any proceeding for that purpose and promptly use its best efforts to prevent the issuance of any stop order or to obtain its withdrawal if such stop order should be issued;

(j) not file any amendment or supplement to such registration statement or prospectus to which Digi's legal counsel shall have reasonably objected on the grounds that such amendment or supplement does not comply in all material respects with the requirements of the Securities Act or the rules and regulations thereunder, after having been furnished with a copy thereof at least five business days prior to the filing thereof, unless in the opinion of counsel for the Company the filing of such amendment or supplement is reasonably necessary to protect the Company from any liabilities under any applicable federal or state law and such filing will not violate applicable law; and

(k) at the request of Digi, furnish: (i) an opinion, dated as of the closing date, of the counsel representing the Company for the purposes of such registration, addressed to the underwriters, if any, and to Digi, covering such matters as such underwriters and Digi may reasonably request; and (ii) letters dated as of the effective date of the registration statement and as of the closing date, from the independent certified public accountants of the Company, addressed to the underwriters, if any, and to Digi, covering such matters as such underwriters and Digi may reasonably request.

11.4 OBLIGATION OF COOPERATION. Digi shall have the obligation to cooperate with all reasonable requests of Company in connection with the preparation of and response to all documents contemplated by Section 11.3 above, and timely to provide any information reasonably necessary for the registration contemplated therein.

11.5 EXPENSES. With respect to each registration requested pursuant to Sections 11.1 and 11.2 hereof and with respect to each inclusion of Conversion Stock in a registration statement pursuant to Sections 11.1 and 11.2 hereof, the Company shall bear the following fees, costs and expenses: all registration, filing and NASD fees, printing expenses, fees and disbursements of counsel and accountants for the Company, fees and disbursements of counsel for the underwriter or underwriters of such securities (if the Company and/or Digi are required to bear such fees and disbursements), all internal Company expenses, all legal fees and disbursements and other expenses of complying with state securities or blue sky laws of any jurisdictions in which the securities to be offered are to be registered or qualified, and the premiums and other costs of policies of insurance against liability (if any) arising out of such public offering. Fees and disbursements of counsel and accountants for Digi, underwriting discounts and commissions and transfer taxes relating to the shares included in the offering by Digi, and any other expenses incurred by Digi not expressly included above, shall be borne by Digi.

11.6 INDEMNIFICATION. In the event that any Conversion Stock is included in a registration statement under Section 11.1 or Section 11.2 hereof:

(a) The Company will indemnify and hold harmless Digi pursuant to the provisions of this Section 11, its directors and officers, and any underwriter (as defined in the Securities Act) for Digi and each person, if any, who controls Digi or such underwriter within the meaning of the Securities Act, from and against, and will reimburse Digi and each such underwriter and controlling person with respect to, any and all loss, damage, liability, cost and expense to which Digi or any such underwriter or controlling person may become subject under the Securities Act or otherwise, insofar as such losses, damages, liabilities, costs or expenses are caused by any untrue statement or alleged untrue statement of any material fact contained in such registration statement, any prospectus contained therein or any amendment or supplement thereto, or arise out of or are based upon the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances in which they were made, not misleading; provided, however, that the Company will not be liable in any such case to the extent that any such loss, damage, liability, cost or expense arises out of or is based upon an untrue statement or alleged untrue statement or omission or alleged omission so made in conformity with information furnished by Digi, such underwriter

or such controlling person in writing specifically for use in the preparation thereof.

(b) Digi will indemnify and hold harmless the Company, its directors and officers, any controlling person and any underwriter from and against, and will reimburse the Company, its directors and officers, any controlling person and any underwriter with respect to, any and all loss, damage, liability, cost or expense to which the Company or any controlling person and/or any underwriter may become subject under the Securities Act or otherwise, insofar as such losses, damages, liabilities, costs or expenses are caused by any untrue or alleged untrue statement of any material fact contained in such registration statement, any prospectus contained therein or any amendment or supplement thereto, or arise out of or are based upon the omission or the alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances in which they were made, not misleading, in each case to the extent, but only to the extent, that such untrue statement or alleged untrue statement or omission or alleged omission was so made in reliance upon and in strict conformity with written information furnished by Digi specifically for use in the preparation thereof.

(c) Promptly after receipt by an indemnified party pursuant to the provisions of paragraph (a) or (b) of this Section 11.6 of notice of the commencement of any action involving the subject matter of the foregoing indemnity provisions such indemnified party will, if a claim thereof is to be made against the indemnifying party pursuant to the provisions of said paragraph (a) or (b), promptly notify the indemnifying party of the commencement thereof; but the omission to so notify the indemnifying party will not relieve it from any liability which it may have to any indemnified party otherwise than hereunder. Such omission will not relieve the Company of its obligation to indemnify Digi so long as this failure to provide notice does not prejudice the interests of Company. In case such action is brought against any indemnified party and it notifies the indemnifying party of the commencement thereof, the indemnifying party shall have the right to participate in, and, to the extent that it may wish, jointly with any other indemnifying party similarly notified, to assume the defense thereof, with counsel reasonably satisfactory to such indemnified party, provided, however, if the defendants in any action include both the indemnified party and the indemnifying party and the indemnified party shall have reasonably concluded that there are legal defenses available to it and/or other indemnified parties which are different from or additional to those available to the indemnifying party, or if there is a conflict of interest which would prevent counsel for the indemnifying party from also representing the indemnified party, the indemnified party or parties shall have the right to select separate counsel to participate in the defense of such action on behalf of such indemnified party or parties, which counsel shall be reasonably satisfactory to the indemnifying party. For these purposes Faegre & Benson LLP shall be deemed to be satisfactory counsel to Digi, and both Fredrikson & Byron and the Law Offices of Joan Squires-Lind shall be deemed satisfactory to the Company. After notice from the indemnifying party to such indemnified party of its election so to assume the defense thereof, the indemnifying party will not be liable to such indemnified party pursuant to the provisions of said paragraph (a) or (b) for any legal or other expense subsequently incurred by such indemnified party in connection with the defense thereof other than reasonable costs of investigation and cooperation, unless (i) the indemnified party shall have employed counsel in accordance with the proviso of the preceding sentence, (ii) the indemnifying party shall not have employed counsel reasonably satisfactory to the indemnified party to represent the indemnified party within a reasonable time after the notice of the commencement of the action, or (iii) the indemnifying party has authorized the employment of counsel for the indemnified party at the expense of the indemnifying party.

12. DEFAULT BY THE COMPANY

12.1 EVENTS OF DEFAULT. Each of the following events shall be an event of default by the Company for purposes of this Agreement, the Notes and the Ancillary Documents (an "Event of Default"):

(a) if default shall be made in the punctual payment of the principal or accrued interest on any of the Notes; or

(b) if any judgment, writ or warrant of attachment or of any similar process in an amount in excess of \$400,000 shall be entered or filed against the Company or against any of its property or assets and either remains unpaid, unvacated, unbonded or unstayed for a period of 30 days or adequate reserves are not established on the Company's books; or

(c) if an order for relief shall be entered in any Federal bankruptcy proceeding in which the Company is the debtor, or if bankruptcy, reorganization, arrangement, insolvency, or liquidation proceedings, or other proceedings for relief under any bankruptcy or similar law or laws for the relief of debtors, are instituted by or against the Company and, if instituted against the Company, are consented to or, if contested by the Company, are not dismissed by the adverse parties or by an order, decree or judgment within 60 days after such institution; or

(d) if the Company shall default in any material respect in the due and punctual performance of any covenant or agreement in any note (including without limitation any of the Notes), bond, indenture, loan agreement, note agreement, mortgage, security agreement (including without limitation the Security Agreement) or other instrument evidencing or related to indebtedness for borrowed money, and such default shall continue for more than the period of notice and/or grace, if any, therein specified and shall not have been waived; or

(e) (i) if any representation or warranty made by or on behalf of the Company in this Agreement or in any certificate, report or other instrument delivered under or pursuant to any term hereof shall prove to have been untrue or incorrect in any material respect as of the date of this Agreement or as of any Closing Date, or (ii) if any report, certificate, financial statement or financial schedule or other instrument prepared or purported to be prepared by the Company or any officer of the Company furnished or delivered under or pursuant to this Agreement after the Closing Date shall prove to be untrue or incorrect in any material respect as of the date it was made, furnished or delivered; or

(f) if default shall be made by the Company in the due and punctual performance or observance of any other term contained in this Agreement, any Note or in any Ancillary Agreement, which is to be performed or observed by the Company, and such default shall not have been remedied, or the Company shall have not taken steps to remedy such default to Digi's reasonable satisfaction, within 15 days after written notice thereof to the Company by Digi.

12.2 REMEDIES UPON EVENTS OF DEFAULT OF THE COMPANY

(a) Note A

(i) Upon the occurrence of an Event of Default under Sections 12.1(a), 12.1(b), 12.1(d), 12.1(e), or 12.1(f) the Company shall have a period of ninety days (90 days) in which to cure said Event of Default. Thereupon, unless such Event of Default shall have been cured, or waived by Digi, Digi shall be entitled by notice to the company to declare the principal of Note A to be immediately due and payable.

(ii) Upon the occurrence of an Event of Default of the Company described in Section 12.1(c) Note A shall immediately become due and payable without presentment, demand or notice of any kind.

(b) Note B

(i) Upon the occurrence of an Event of Default under Sections 12.1(a), 12.1(b), 12.1(d), 12.1(e), or 12.1(f) the Company shall have a period of thirty days (30 days) in which to cure said Event of Default. Thereupon, unless such Event of Default shall have been cured, or waived by Digi, Digi shall be entitled by notice to the Company to declare the principal and accrued interest of Note B to be immediately due and payable.

(ii) Upon the occurrence of an Event of Default of the Company described in Section 12.1(c) the Note shall immediately become due and payable without presentment, demand or notice of any kind.

12.3 NOTICE OF DEFAULTS TO BE GIVEN BY COMPANY.

(a) When, to its knowledge, any Event of Default has occurred or exists, the Company agrees to give prompt written notice of such Event of Default to Digi, but in any event within ten business days.

(b) When, to its knowledge, an Event of Default under Sections 12.1(a), (b), (c), (d) or (f) is imminent, which default could be avoided by the prompt securing of interim financing, the Company agrees to give prompt written notice of such prospective Event of Default, and to consult with Digi about alternative possibilities for obtaining interim financing.

12.4 SUITS FOR ENFORCEMENT; REMEDIES CUMULATIVE AND NOT WAIVED BY DIGI. In case an Event of Default shall have occurred and be continuing, Digi may proceed to protect and enforce its rights under this Section 12 by suit in equity or action at law. No right, power or remedy conferred upon Digi shall be exclusive, and each such right, power or remedy shall be cumulative and in addition to every other right, power or remedy, whether conferred hereby or by any such security now or hereafter available at law or in equity or by statute or otherwise. No course of dealing between the Company and Digi and no delay in exercising any right, power or remedy conferred hereby or by any such security or now or hereafter existing at law or in equity or by statute or otherwise, shall operate as a waiver of or otherwise prejudice any such right, power or remedy; provided, however, that this sentence shall not be construed or applied so as to negate the provisions and intent of any statute which is otherwise applicable.

13. SURVIVAL OF CERTAIN COVENANTS. The obligations of the Company under Section 8 (other than its obligations under Sections 8.1, 8.2, 8.3, 8.4, 8.5, 8.10(b), 8.11 and 8.12 above) shall notwithstanding any provisions hereof apparently to the contrary, terminate and be of no further force or effect from and after the earlier of the repayment in full of the Notes or the Initial Public Offering.

14. CONSENTS; WAIVERS AND AMENDMENTS. With the written consent of either Party hereto, any obligation of the other Party to this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively), and by mutual written consent the Parties may enter into a supplementary agreement for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of this Agreement or of any supplemental agreement or modifying in any manner the rights and obligations of either Party.

15. CHANGES, WAIVERS, ETC. Neither this Agreement nor any provision hereof may be changed, waived, discharged or terminated orally, but only by a statement in writing signed by the Party against which enforcement of the change, waiver, discharge or termination is sought.

16. PAYMENT OF FEES AND EXPENSES. Each Party will bear the out-of-pocket expenses incurred by it in connection with the transactions herein contemplated, including without limitation the fees and out-of-pocket expenses of counsel.

17. NOTICES. All notices, requests, consents and other communications required or permitted hereunder shall be in writing and shall be personally delivered, or mailed certified mail, return receipt requested, registered or certified mail. Notices shall be effective upon receipt.

(a) if to Digi, addressed to it at 11001 East Bren Road, Minnetonka, MN, Attn: Chief Financial Officer, or at such other address as Digi may specify by

written notice to the Company, or

(b) if to the Company, addressed to it at 445 Minnesota Street, Suite 2400, St. Paul MN 55101-2139, Attn: Dr. Jonathan A. Henrikssen Sachs, with a copy to the Law Offices of Joan Squires-Lind, 6 rue du Foin, 75003 Paris France or to such other addresses as the Company may specify by written notice to Digi, and such notices and other communications shall for all purposes of this Agreement be treated as being effective or having been given when delivered, if delivered personally, or, if sent by first class postage prepaid registered or certified mail, when received.

19. SUCCESSORS AND ASSIGNS. Neither this Agreement, nor any of the rights or obligations thereunder, shall be assignable without the prior written consent of the other Party. However any transferee of at least 25% of the Conversion Stock shall be entitled, without the Company's consent, and together with Digi and all other transferees of at least 25% of the Conversion Stock, to the benefits of demand registration rights for such Conversion Stock provided by Section 11.1, and any transferee of at least 10% of the Conversion Stock shall be entitled, without the Company's consent, and together with Digi and all other transferees of at least 10% of the Conversion Stock to the benefits of the incidental registration rights for such Conversion Stock provided by Section 11.2.

20. HEADINGS. The headings of the Sections of this Agreement have been inserted for convenience of reference only and do not constitute a part of this Agreement.

21. CHOICE OF LAW. It is the intention of the Parties that the laws of Minnesota shall govern the validity of this Agreement, the construction of its terms and the interpretation of the rights and duties of the Parties.

22. COUNTERPARTS. This Agreement may be executed concurrently in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the Parties have executed this Agreement as of the date first above written.

DIGI INTERNATIONAL INC.

By /s/ Jerry A. Dusa

Name: Jerry A. Dusa
Its: President & C.E.O.

AETHERWORKS CORPORATION

By /s/ Robert C. Lind

Name: Robert C. Lind, Ph.D.
Its: Director

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SCHEDULE A

Guaranteed Indebtedness (Section 6.9)

Dollar Amount Guaranteed as of October 14, 1997

Sanwa Leasing Corporation P O Box 7023 Troy MI 48007-702	\$	569,158.07
Carlton Financial Corporation 7831 Glenroy Road, #102 Edina MN 55349	\$	1,832,725.83
Koll Real Estate Company 30 East Seventh Street St. Paul MN 55101	\$	250,000.00 - letter of credit
Central Computer Systems Inc. 3777 Stevens Creek Boulevard Santa Clara CA 95051	\$	26,114.40 - four months rent

The Carlton lease contains an obligation to purchase the leased equipment at 20% of the Lessor's Total Cost at the end of the lease period. The amount is \$382,304.94.

Litigation (Section 6.10)

The Company received written notice from Sun Microsystems Company on 30 May 1997 of its intention to initiate litigation in the US District Court for the Northern District of California, San Jose Division, and in the State of Minnesota, District Court, County of Hennepin, Fourth Judicial District, in connection with a commercial dispute concerning approximately \$2,000,000 of computer equipment. On information and belief, this dispute has been resolved, through the payment of certain sums of money by Digi International Inc. to Sun Microsystems Computer Company. The equipment in question is the subject of the Equipment Lease referred to in Section 5.8 of this Agreement. On information and belief, releases have been obtained in favor of both Digi International Inc. and AetherWorks Corporation, but these releases have not been reviewed or received by AetherWorks. The source of the Company's information and belief is information received from Digi International Inc.

October 1, 1997

COURIER

Mr. Dino G. Kasdagly
2910 Stonegate Court SouthWest
Rochester, MN 55902

Dear Dino:

As we discussed earlier today, I am pleased that the Board of Directors has unanimously voted to name you Sr. Vice President, Development and an Officer of the company. Needless to say, we are excited to have you become part of our team.

The Board has approved your starting base pay of \$175,000 per year and options on 50,000 shares of Digi stock. Your options will be at the market price on the first day of employment and will vest over five years at a rate of 20% (10,000 shares) per year. You will also receive a \$20,000 net one-time payment in January 1998.

Your position has an annualized incentive target of 60% of base salary earnings. Incentive payouts are based on a combination of corporate and personal performance. The corporate portion of this program is profit sharing in nature and requires a threshold level of corporate performance before any incentive payouts are made. Incentive payouts for part year participation will be handled on a pro rata basis.

Digi will provide you with a furnished apartment from the beginning of your employment through June 1998. We would expect you to relocate with your family to the Twin Cities area during the summer of 1998. Digi will cover relocation costs including house-hunting trips and expenses in accordance with our relocation policy.

In addition, Digi offers a comprehensive benefit program which includes Medical, Dental and Disability Insurance, Medical and Dependent Care Reimbursement Plan, 401(k) Saving Plan, Employee Stock Purchase Plan, and Paid Vacation. You will be eligible for participation in Digi's health insurance programs on the first day of the month following 30 days of employment with the company. You will be eligible for participation in the 401(k) savings plan and the Stock Purchase Plan on the first of January, April, July or October following 30 days of employment. As agreed, you will be entitled to four weeks of vacation. Vacation accrual begins on the date of hire.

FINANCIAL INFORMATION

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MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

The following table sets forth selected information derived from the Company's Consolidated Statements of Operations, expressed as a percentage of net sales.

	Year ended September 30			Percentage increase/(decrease)	
	1997	1996	1995	1997 OVER 1996	1996 OVER 1995
NET SALES	100.0%	100.0%	100.0%	(14.3)%	17.1%
COST OF SALES	51.6	48.2	47.8	(8.2)	18.0
GROSS MARGIN	48.4	51.8	52.2	(19.9)	16.3
OPERATING EXPENSES:					
SALES AND MARKETING	22.1	22.5	19.1	(15.6)	37.3
RESEARCH AND DEVELOPMENT	10.9	11.0	8.9	(15.5)	43.6
GENERAL AND ADMINISTRATIVE	11.7	7.9	7.6	27.0	24.9
RESTRUCTURING	6.3			100.0	
	51.0	41.4	35.6	5.6	36.3
OPERATING (LOSS) INCOME	(2.6)	10.4	16.6	(121.5)	(26.6)
OTHER INCOME, PRINCIPALLY INTEREST	0.1	0.2	1.2	(53.6)	(83.1)
AETHERWORKS CORPORATION NET LOSS	(3.5)	(1.9)		59.1	100.0
AETHERWORKS CORPORATION WRITE OFF	(3.5)			100.0	
(LOSS) INCOME BEFORE INCOME TAXES	(9.5)	8.7	17.8	(193.4)	(42.8)
PROVISION FOR INCOME TAXES		3.9	6.1	(98.8)	(25.2)
NET (LOSS) INCOME	(9.5)%	4.8%	11.7%	(269.0)%	(51.9)%

NET SALES

The decrease in net sales from 1996 to 1997 of \$27.6 million and the increase in net sales from 1995 to 1996 of \$28.2 million were dispersed between the Company's two principal product groups as follows:

Product Market	Percent of Annual Net Sales			Annual Sales Increase (Decrease)	
	1997	1996	1995	1997	1996
SERVER BASED	75.7%	80.2%	81.6%	(19.1%)	15.1%
PHYSICAL LAYER	23.9%	18.9%	18.4%	8.2%	20.3%
OTHER	.4%	.9%		(56.5%)	N/A

Net sales for 1997 were lower than those for 1996 due to a conscious effort by the Company to reduce inventory levels in the distribution channel. In addition, sales for 1997 were net of customer rebates of \$3.5 million, as compared to rebates of \$2.7 million for 1996. Net sales for 1996 were higher than those for 1995, primarily due to increased volume.

Net sales to original equipment manufacturers (OEMs), as a percentage of total net sales, rose to 23.5% for 1997, as compared to 20.3% in 1996. Net sales to OEMs for 1995 were 22.9%. The Company expects the OEM portion of the Company's business for fiscal 1998 to remain relatively stable with the 1997 level.

Net sales to the distribution market, as a percentage of total net sales, declined to 64.1% for 1997, as compared to 65.5% in 1996. This decline was a result of a conscious effort by the Company to reduce inventory levels in the distribution channel. Net sales to the distribution market for 1995 represented 61.2% of total net sales.

The effort by the Company to reduce inventory levels in the distribution channel has continued through the first quarter of fiscal 1998, ending December 31, 1997.

During fiscal years 1997, 1996 and 1995, the Company's net sales to customers outside the United States, primarily in Europe, amounted to approximately \$39.6 million, \$39.9 million and \$33 million, respectively, comprising approximately 23.9%, 20% and 20%.

GROSS MARGIN

Gross margin for 1997 declined to 48.4%, as compared to 51.8% and 52.2% for 1996 and 1995, respectively. Such decline in 1997 was principally due to the increase of OEM and physical layer product net sales as a percentage of total net sales. OEM and physical layer products generally contribute lower gross margins, as compared to sales to the distribution channel and sales of multiuser and remote access products. In addition, the Company has increased its reserves for excess and obsolete inventories by approximately \$1.5 million in 1997 versus 1996. Such reserves increased by approximately \$.7 million in 1996, in comparison to 1995.

OPERATING EXPENSES

Operating expenses for 1997 declined 7.5% from operating expenses for 1996, without consideration of the approximately \$10.5 million restructuring charge recorded in 1997. Such decline was due to decreased marketing costs and cost savings achieved through consolidation of research and development efforts, as well as a reduction of funding levels for new product development. The 1996 operating expenses increased 36.3% over 1995 levels due to expansion of the Company's infrastructure and increased product development costs.

The restructuring charge of approximately \$10.5 million, recorded in the second quarter of fiscal 1997, related to a Board-approved plan that simplified operations, increased consolidation and reduced costs and expenses. The plan included the closing of the Cleveland, Ohio manufacturing facility, the reduction of selected product lines and the consolidation and closing of the Torrance, California and Nashville, Tennessee research and development facilities. These costs included: (i) write downs of the carrying values of fixed assets related to the closed manufacturing and research and development facilities, (ii) write downs of carrying values of goodwill and identifiable intangible assets (primarily licensing agreements related to the discontinued product lines) and related inventories and (iii) severance costs associated with the elimination of 105 positions.

Subsequent to the actions covered by the restructuring charge, the Company has made additional headcount reductions and has consolidated other research and development activities into its Minneapolis facilities. Actual headcount for the Company as of September 30, 1997 was 481, down from 714 at January 31, 1997.

The Company expects that operating expenses for fiscal 1998 will remain at levels similar to or slightly higher than the \$16.4 million incurred in the fourth quarter of fiscal 1997.

OTHER INCOME

Other income for 1997 declined by 53.6% from 1996 levels due primarily to increased losses on disposal of capital assets, principally at its research and

development location in Cleveland. Other income for 1996 declined by 83.0% from 1995 levels due primarily to lower interest income resulting from a decrease in invested funds as well as losses on disposal of capital assets.

AETHERWORKS CORPORATION OPERATING LOSSES

In connection with the purchase of convertible notes from AetherWorks Corporation, a development stage company engaged in the development of wireless and dial-up remote access technology, the Company has the ability, under certain conditions, to convert its investment into a majority of AetherWorks' common stock. The Company has reported its investment in AetherWorks on the equity method and has recorded net losses of \$5.8 million and \$3.6 million, respectively, for 1997 and 1996. These net losses represent 100% of AetherWorks' losses for such years. The percentage of AetherWorks' net losses included in the Company's financial statements is based upon the percentage of financial support provided by the Company (versus other investors) to AetherWorks during such years.

In connection with the financing arrangement, the Company has also guaranteed \$3,060,000 of lease obligations of AetherWorks. In addition, the Company has also leased to AetherWorks \$1,325,000 of computer equipment under a three-year direct financing lease.

On October 14, 1997, the Company entered into a revised note agreement with AetherWorks, that clarifies and limits the Company's financial commitment for the purchase of convertible notes of up to a maximum of \$13.8 million, which would result in the Company's ownership interest upon conversion of 62.7% based on AetherWorks' present capitalization. The revised agreement, however, also provides for payments, at the discretion of AetherWorks, on the outstanding convertible notes of up to \$7.2 million in exchange for a reduction in the Company's potential ownership interest, upon conversion, to 19%. The revised note agreement, among other things, rescinded previous technology transfer and manufacturing agreements.

Because of the significant uncertainty of the future of AetherWorks Corporation, as demonstrated by its lack of generating positive cash flow, obtaining other sources of equity financing and its continued uncertainty in developing commercially marketable products, the Company decided, as of September 30, 1997, to write off its remaining investment of \$2.4 million in AetherWorks, and to accrue and expense its remaining future obligation to purchase additional notes of \$2.0 million. In addition, the Company has also accrued \$1.4 million for its probable obligations resulting from its guarantees of certain AetherWorks' lease obligations.

INCOME TAXES

The Company recorded a \$.1 million tax provision for 1997, even though it has reported a pre-tax loss for the year. Such provision was necessary due to the non-deductibility of certain intangible assets written off as part of the restructuring charge, the AetherWorks operating losses, and the related investment write off. In addition, the Company has also provided additional provision in connection with an IRS examination of certain tax returns filed in prior years. The Company's effective income tax rate increased from 34.2% in 1995 to 44.7% in 1996 due primarily to the non-deductibility of the AetherWorks losses.

INFLATION

The Company believes inflation has not had a material effect on its operations or on its financial condition.

LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations principally with funds generated from operations, and in prior years, with proceeds from earlier public offerings. Investing activities for 1997 consisted of purchases of \$8.8 million of equipment and capital improvements, including a new enterprise-wide computer system, which will provide Year 2000 capabilities, and the purchase of \$6.5 million of additional convertible notes from AetherWorks Corporation.

During 1997, the Company has increased its cash balances by approximately \$22.4 million, through cash flow from operations, principally due to reductions in its outstanding accounts receivable and inventory levels.

Investing activities for 1996 consisted primarily of the redemption of maturing investments offset by purchases of property and equipment, and purchases of \$5.3 million of convertible notes from AetherWorks Corporation.

During 1996, the Company made open market purchases of the Company's common stock aggregating \$7.3 million pursuant to a one million share repurchase program authorized by the Company's Board of Directors on March 27, 1995. On January 31, 1996, the Board of Directors authorized a separate 500,000 share repurchase program for the purpose of purchasing common stock to be utilized for the Company's Employee Stock Purchase Plan, which purchase was funded through employee withholding. The Company suspended all existing stock purchase programs at its October 1996 board meeting, and does not presently contemplate any such stock purchase programs in the near future.

At September 30, 1997, the Company had working

capital of \$62 million and no debt. The Company has negotiated a \$5 million unsecured line of credit with its bank, but has not utilized such line. The Company's management believes that current financial resources, cash generated from operations and the Company's potential capacity for debt and/or equity financing will be sufficient to fund current and anticipated business operations.

FOREIGN CURRENCY TRANSLATION

Substantially all of the Company's foreign transactions are negotiated, invoiced and paid in U.S. dollars.

NEW ACCOUNTING STANDARD

In March 1997, the Statement of Financial Accounting Standards No. 128 (SFAS No. 128), Earnings Per Share, was issued by the Financial Accounting Standards Board. This standard, which the Company must adopt for its 1998 fiscal interim and year-end reporting, requires dual presentation of basic and diluted EPS on the face of the Statement of Operations. Net income or loss per share currently (except for 1997) includes both common shares outstanding and common stock equivalents. The basic income or loss per share under SFAS No. 128 will be calculated based on only common shares outstanding. Diluted income or loss per share would be calculated based on both common shares outstanding and consideration of the dilutive effect of common stock equivalents.

FORWARD-LOOKING STATEMENTS

Certain statements made in this annual report, which are summarized here, are forward-looking statements that involve risk and uncertainties, and actual results may be materially different. Factors that could cause actual results to differ include, but are not limited to those identified:

- - DIGI'S OPEN SYSTEM SERVER-BASED COMMUNICATIONS STRATEGY SHOULD BE CHARACTERIZED AS FORWARD LOOKING AND, AS SUCH, MAY INVOLVE RISKS AND UNCERTAINTIES.
- - CONTINUED GROWTH IN SALES OF THE COMPANY'S MULTIUSER, REMOTE ACCESS AND LAN PRODUCTS -- General market conditions and competitive conditions within these markets, development and acceptance of new products offered by the Company, and the introduction of products by competitors in these markets.
- - THE EXPECTATION THAT STEPS TAKEN BY THE COMPANY WILL BRING IT BACK TO CONSISTENT PROFITABILITY -- This expectation may be impacted by unanticipated expenses or general market conditions and competitive conditions that may be encountered.
- - THE EXPECTATION THAT OPERATING EXPENSES IN FISCAL 1998 WILL REMAIN AT LEVELS SIMILAR TO OR SLIGHTLY HIGHER THAN THOSE INCURRED IN THE FISCAL FOURTH QUARTER OF 1997 -- This expectation may be impacted by presently unanticipated revenue opportunities or by unanticipated expenses.
- - THE EXPECTATION THAT AETHERWORKS CORPORATION WILL NOT GENERATE POSITIVE CASH FLOW, OBTAIN OTHER SOURCES OF EQUITY FINANCING OR DEVELOP COMMERCIALY MARKETABLE PRODUCTS -- This expectation may be impacted by presently unanticipated revenue opportunities, securing other investors or developing commercially marketable products.
- - THE EXPECTATION THAT OEM SALES FOR FISCAL 1998 WILL REMAIN RELATIVELY STABLE WITH 1997 LEVELS-- OEM orders are subject to cancellation at the option of the customer, and are subject to greater quarterlyfluctuations than sales through the Company's other channels, as well as competitive conditions in markets served by the Company's OEM customers. OEM sales could also be adversely impacted by component shortages.
- - THE EXPECTATION THAT THE COMPANY DOES NOT CONTEMPLATE ANY STOCK PURCHASE PROGRAMS IN THE NEAR FUTURE -- Changes in operating results, credit availability and equity market conditions may impact the Company's decision to resume such stock purchase programs.
- - THE BELIEF THAT THE COMPANY'S CURRENT FINANCIAL RESOURCES, CASH GENERATED FROM OPERATIONS AND THE COMPANY'S POTENTIAL CAPACITY FOR DEBT AND/OR EQUITY FINANCING WILL BE SUFFICIENT TO FUND CURRENT AND ANTICIPATED BUSINESS OPERATIONS -- Changes in anticipated operating results, credit availability and equity market conditions may further enhance or inhibit the Company's ability to maintain or raise appropriate levels of cash.

DIGI INTERNATIONAL INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE FISCAL YEARS ENDED SEPTEMBER 30	1997	1996	1995
NET SALES	\$ 165,597,937	\$ 193,150,898	\$ 164,978,018
COST OF SALES	85,482,536	93,108,624	78,933,221
GROSS MARGIN	80,115,401	100,042,274	86,044,797
OPERATING EXPENSES:			
SALES AND MARKETING	36,671,271	43,449,864	31,643,800
RESEARCH AND DEVELOPMENT	17,978,135	21,279,551	14,816,413
GENERAL AND ADMINISTRATIVE	19,324,777	15,215,512	12,186,056
RESTRUCTURING	10,471,482		
TOTAL OPERATING EXPENSES	84,445,665	79,944,927	58,646,269
OPERATING (LOSS) INCOME	(4,330,264)	20,097,347	27,398,528
OTHER INCOME, NET	153,809	331,789	1,967,565
AETHERWORKS CORPORATION NET LOSS	(5,764,201)	(3,623,776)	
AETHERWORKS CORPORATION WRITE OFF	(5,758,548)		
(LOSS) INCOME BEFORE INCOME TAXES	(15,699,204)	16,805,360	29,366,093
PROVISION FOR INCOME TAXES	91,640	7,505,140	10,035,000
NET (LOSS) INCOME	\$ (15,790,844)	\$ 9,300,220	\$ 19,331,093
(LOSS) INCOME PER COMMON AND COMMON EQUIVALENT SHARE	\$ (1.18)	\$.69	\$ 1.38
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING	13,393,408	13,522,905	14,057,109

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED FINANCIAL STATEMENTS.

DIGI INTERNATIONAL INC.

CONSOLIDATED BALANCE SHEETS

	SEPTEMBER 30 1997	SEPTEMBER 30 1996

ASSETS		
CURRENT ASSETS:		
CASH AND CASH EQUIVALENTS	\$ 31,329,666	\$ 8,943,390
ACCOUNTS RECEIVABLE, NET	25,658,522	42,874,898
INVENTORIES, NET	23,683,312	33,372,164
INCOME TAX REFUND RECEIVABLE		1,675,626
OTHER	4,147,942	2,825,828

TOTAL CURRENT ASSETS	84,819,442	89,691,906
PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET	23,617,696	24,230,101
INTANGIBLE ASSETS, NET	6,876,597	10,854,845
INVESTMENT IN AETHERWORKS CORPORATION		1,672,749
OTHER	2,997,601	3,489,228

TOTAL ASSETS	\$ 118,311,336	\$ 129,938,829

LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
ACCOUNTS PAYABLE	\$ 10,118,921	\$ 12,549,738
INCOME TAXES PAYABLE	1,771,986	
ACCRUED EXPENSES:		
ADVERTISING	2,847,672	3,761,619
COMPENSATION	2,388,468	1,622,549
ACCRUED AETHERWORKS CORPORATION FUNDING OBLIGATIONS	3,350,000	
OTHER	2,363,258	2,061,782

TOTAL CURRENT LIABILITIES	22,840,305	19,995,688

COMMITMENTS AND CONTINGENCY		
STOCKHOLDERS' EQUITY:		
PREFERRED STOCK, \$.01 PAR VALUE: 2,000,000 SHARES AUTHORIZED; NONE OUTSTANDING		
COMMON STOCK, \$.01 PAR VALUE; 60,000,000 SHARES AUTHORIZED; 14,727,256 AND 14,677,150 SHARES ISSUED	147,273	146,772
ADDITIONAL PAID-IN CAPITAL	44,403,102	42,866,758
RETAINED EARNINGS	75,113,902	90,904,746

	119,664,277	133,918,276
UNEARNED STOCK COMPENSATION	(1,787,658)	(295,156)
TREASURY STOCK, AT COST, 1,269,492 AND 1,338,894 SHARES	(22,405,588)	(23,679,979)

TOTAL STOCKHOLDERS' EQUITY	95,471,031	109,943,141

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 118,311,336	\$ 129,938,829

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED FINANCIAL STATEMENTS.

DIGI INTERNATIONAL INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE FISCAL YEARS ENDED SEPTEMBER 30	1997	1996	1995
OPERATING ACTIVITIES:			
NET (LOSS) INCOME	\$ (15,790,844)	\$ 9,300,220	\$ 19,331,093
ADJUSTMENTS TO RECONCILE NET (LOSS) INCOME TO CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:			
PROVISION FOR RESTRUCTURING	9,211,713		
DEPRECIATION OF PROPERTY AND EQUIPMENT	5,587,132	5,017,735	2,289,554
AETHERWORKS CORPORATION NET LOSS	5,764,201	3,623,776	
AETHERWORKS CORPORATION WRITE OFF	5,758,548		
AMORTIZATION OF INTANGIBLES	1,114,023	1,320,457	1,132,006
LOSS ON SALE OF FIXED ASSETS	760,555	238,222	
PROVISION FOR LOSSES ON ACCOUNTS RECEIVABLE	1,933,251	262,164	243,895
PROVISION FOR INVENTORY OBSOLESCENCE	2,910,988	1,455,895	716,300
DEFERRED INCOME TAXES	(1,787,933)	(393,153)	(84,750)
STOCK COMPENSATION	244,569	204,973	166,667
CHANGES IN OPERATING ASSETS AND LIABILITIES:			
ACCOUNTS RECEIVABLE	15,283,125	(11,176,126)	(10,457,106)
INVENTORIES	3,780,241	(7,808,974)	(4,043,377)
INCOME TAXES PAYABLE/RECEIVABLE	3,447,612	(1,545,461)	(1,157,823)
OTHER ASSETS	713,772	(1,953,252)	(1,266,098)
ACCOUNTS PAYABLE	(2,430,817)	443,223	7,420,550
ACCRUED EXPENSES	153,448	(664,452)	1,365,901
TOTAL ADJUSTMENTS	52,444,428	(10,974,973)	(3,674,281)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	36,653,584	(1,674,753)	15,656,812
INVESTING ACTIVITIES:			
PURCHASE OF PROPERTY AND EQUIPMENT	(8,841,473)	(12,902,436)	(9,573,995)
PROCEEDS FROM SALE OF FIXED ASSETS		1,133,197	
PROCEEDS FROM HELD-TO-MATURITY MARKETABLE SECURITIES		20,640,962	25,004,985
PROCEEDS FROM AVAILABLE-FOR-SALE MARKETABLE SECURITIES		13,060,000	
PURCHASE OF HELD-TO-MATURITY MARKETABLE SECURITIES		(482,187)	(21,751,326)
PURCHASE OF AVAILABLE-FOR-SALE MARKETABLE SECURITIES		(5,250,000)	(7,810,000)
BUSINESS ACQUISITIONS, NET OF CASH REQUIRED			(5,487,374)
INVESTMENT IN AETHERWORKS CORPORATION	(6,500,000)	(5,296,525)	
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(15,341,473)	10,903,011	(19,617,710)
FINANCING ACTIVITIES:			
PURCHASE OF TREASURY STOCK		(7,249,325)	(5,930,313)
STOCK OPTION TRANSACTIONS, NET	539,838	1,659,838	1,145,925
EMPLOYEE STOCK PURCHASE PLAN TRANSACTIONS, NET	534,327	200,888	
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	1,074,165	(5,388,599)	(4,784,388)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	22,386,276	3,839,659	(8,745,286)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	\$ 8,943,390	\$ 5,103,731	\$ 13,849,017
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 31,329,666	\$ 8,943,390	\$ 5,103,731
SUPPLEMENTAL CASH FLOW DISCLOSURE: INCOME TAXES PAID			
	\$ 238,439	\$ 8,944,627	\$ 10,815,846

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED FINANCIAL STATEMENTS.

DIGI INTERNATIONAL INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 1997, 1996 AND 1995

	COMMON STOCK SHARES	PAR VALUE	TREASURY STOCK SHARES	STOCK VALUE
BALANCES, SEPTEMBER 30, 1994	14,474,663	\$144,747	755,229	\$(10,701,229)
TREASURY STOCK, AT COST			277,500	(5,930,313)
ISSUANCE OF STOCK OPTIONS BELOW MARKET PRICES				
STOCK COMPENSATION				
ISSUANCE OF STOCK UPON EXERCISE OF STOCK OPTIONS, NET OF WITHHOLDING	88,295	883		
TAX BENEFIT REALIZED UPON EXERCISE OF STOCK OPTIONS				
FORFEITURE OF STOCK OPTIONS				
NET INCOME				
BALANCES, SEPTEMBER 30, 1995	14,562,958	145,630	1,032,729	(16,631,542)
TREASURY STOCK, AT COST			315,000	(7,249,325)
EMPLOYEE STOCK PURCHASE ISSUANCES			(8,835)	200,888
ISSUANCE OF STOCK OPTIONS BELOW MARKET PRICES				
STOCK COMPENSATION				
ISSUANCE OF STOCK UPON EXERCISE OF STOCK OPTIONS	114,192	1,142		
TAX BENEFIT REALIZED UPON EXERCISE OF STOCK OPTIONS				
FORFEITURE OF STOCK OPTIONS				
NET INCOME				
BALANCES, SEPTEMBER 30, 1996	14,677,150	146,772	1,338,894	(23,679,979)
EMPLOYEE STOCK PURCHASE ISSUANCES			(69,402)	1,274,391
ISSUANCE OF STOCK OPTIONS BELOW MARKET PRICES				
STOCK COMPENSATION				
ISSUANCE OF STOCK UPON EXERCISE OF STOCK OPTIONS, NET OF WITHHOLDING	50,106	501		
TAX BENEFIT REALIZED UPON EXERCISE OF STOCK OPTIONS				
FORFEITURE OF STOCK OPTIONS				
NET LOSS				
BALANCES, SEPTEMBER 30, 1997	14,727,256	\$147,273	1,269,492	\$(22,405,588)

	ADDITIONAL PAID-IN- CAPITAL	RETAINED EARNINGS	UNEARNED STOCK COMPENSATION	TOTAL STOCKHOLDERS' EQUITY
BALANCES, SEPTEMBER 30, 1994	\$39,788,556	\$62,273,433	\$ (392,332)	\$ 91,113,175
TREASURY STOCK, AT COST				(5,930,313)
ISSUANCE OF STOCK OPTIONS BELOW MARKET PRICES	448,750		(448,750)	
STOCK COMPENSATION			166,667	166,667
ISSUANCE OF STOCK UPON EXERCISE OF STOCK OPTIONS, NET OF WITHHOLDING	683,315			684,198
TAX BENEFIT REALIZED UPON EXERCISE OF STOCK OPTIONS	461,727			461,727
FORFEITURE OF STOCK OPTIONS	(76,028)		76,028	
NET INCOME		19,331,093		19,331,093
BALANCES, SEPTEMBER 30, 1995	41,306,320	81,604,526	(598,387)	105,826,547
TREASURY STOCK, AT COST				(7,249,325)
EMPLOYEE STOCK PURCHASE ISSUANCES				200,888
ISSUANCE OF STOCK OPTIONS BELOW MARKET PRICES	12,500		(12,500)	
STOCK COMPENSATION			204,973	204,973
ISSUANCE OF STOCK UPON EXERCISE OF STOCK OPTIONS	1,159,569			1,160,711
TAX BENEFIT REALIZED UPON EXERCISE OF STOCK OPTIONS	499,127			499,127
FORFEITURE OF STOCK OPTIONS	(110,758)		110,758	
NET INCOME		9,300,220		9,300,220
BALANCES, SEPTEMBER 30, 1996	42,866,758	90,904,746	(295,156)	109,943,141

EMPLOYEE STOCK PURCHASE ISSUANCES	(740,064)			534,327
ISSUANCE OF STOCK OPTIONS BELOW MARKET PRICES	1,892,015		(1,892,015)	
STOCK COMPENSATION			244,569	244,569
ISSUANCE OF STOCK UPON EXERCISE OF STOCK OPTIONS, NET OF WITHHOLDING TAX BENEFIT REALIZED UPON EXERCISE OF STOCK OPTIONS	379,720			380,221
FORFEITURE OF STOCK OPTIONS	(154,944)		154,944	159,617
NET LOSS		(15,790,844)		(15,790,844)

BALANCES, SEPTEMBER 30, 1997	\$44,403,102	\$75,113,902	\$(1,787,658)	\$ 95,471,031

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED FINANCIAL STATEMENTS.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES

BUSINESS DESCRIPTION

Digi International Inc. (the "Company") is a leading ISO 9001-compliant provider of data communications hardware and software that delivers seamless connectivity solutions for multiuser environments, open systems server-based remote access and LAN (Local Area Network) markets. The Company markets its products through an international network of distributors and resellers, system integrators and OEMs (original equipment manufacturers).

The two major product areas include: 1) communications interface cards for multiuser and remote access environments, and 2) "physical layer" and print server products that enhance the data communications capabilities of a LAN.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

CASH EQUIVALENTS AND MARKETABLE SECURITIES

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

REVENUE RECOGNITION

Sales are recognized at the date of shipment. Estimated warranty costs and customer returns are recorded at the time of sale.

INVENTORIES

Inventories are stated at the lower of cost or fair market value, with cost determined on the first-in, first-out method. Fair market value for raw materials is based on replacement cost and for other inventory classifications based on net realizable value. Appropriate consideration is given to deterioration, obsolescence and other factors in evaluating net realizable value.

PROPERTY, EQUIPMENT AND IMPROVEMENTS

Property, equipment and improvements are carried at cost. Depreciation is provided by charges to operations using the straight-line method based on estimated useful lives, ranging from three to 39 years.

Expenditures for maintenance and repairs are charged to operations as incurred, while major renewals and betterments are capitalized. The assets and related accumulated depreciation accounts are adjusted for asset retirements and disposals with the resulting gain or loss included in operations.

INTANGIBLE ASSETS

Purchased technology, license agreements, covenants not to compete and other intangible assets are recorded at cost. Goodwill represents the excess of cost over the fair value of assets acquired and is being amortized on a straight-line basis over its estimated useful life of 15 years. All other intangible assets are amortized on a straight-line basis over their estimated useful lives of one to five years.

The Company periodically, at least quarterly, analyzes intangible assets for potential impairment, assessing the appropriateness of lives and recoverability of unamortized balances through measurement of undiscounted operating cash flows on a basis consistent with generally accepted accounting principles.

RESEARCH AND DEVELOPMENT

Research and development costs are expensed when incurred. Software development costs are expensed as incurred. Such costs are required to be expensed until the point that

technological feasibility and proven marketability of the product are established. Costs otherwise capitalizable after such point also are expensed because they are insignificant.

INCOME TAXES

Deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Income tax expense is the tax payable for the period and the change during the period in deferred tax assets and liabilities.

Tax credits are accounted for under the flow-through method, which recognizes the benefit in the year in which the credit is utilized.

INCOME (LOSS) PER COMMON SHARE

Income (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares of common stock and common stock equivalents outstanding during each period. Common stock equivalents result from dilutive stock options. No common stock equivalents were included in determining the net loss per common share for the year ended September 30, 1997, because their effect would be antidilutive.

In March 1997, the Statement of Financial Accounting Standards No. 128 (SFAS No. 128), Earnings Per Share, was issued by the Financial Accounting Standards Board. This standard, which the Company must adopt for its 1998 fiscal interim and year-end reporting, requires dual presentation of basic and diluted EPS on the face of the Statement of Operations. Net income (loss) per share currently (except for fiscal 1997) includes both common shares outstanding and common stock equivalents. The basic income or loss per share under SFAS No. 128 will be calculated based on only common shares outstanding. Diluted income or loss per share would be calculated based on both common shares outstanding and consideration of the dilutive effect of common stock equivalents.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant areas which require the use of management's estimates relate to the determination of the allowances for obsolete inventories and uncollectable accounts receivable, sales returns and warranty cost accruals.

STOCK-BASED COMPENSATION

The Company uses the intrinsic value-based method to measure compensation cost for its stock option plan.

2 RESTRUCTURING

On February 13, 1997, the Company's Board of Directors approved a restructuring plan which resulted in a restructuring charge of \$10,471,482 (\$8,283,681, net of tax benefits or \$.62 per share). This corporate restructuring plan simplified operations, increased consolidation and reduced costs and expenses. It included the closing of the Cleveland, Ohio manufacturing facility, the reduction of selected product lines and the consolidation and closing of the Torrance, California and Nashville, Tennessee research and development facilities. These costs included: (i) write downs of the carrying values of fixed assets related to the closed manufacturing and research and development facilities, (ii) write downs of the carrying values of goodwill and identifiable intangible assets (primarily licensing agreements related to the discontinued product lines) and related inventories and (iii) severance costs associated with the elimination of 105 positions.

The restructuring charge consisted of \$1,259,769 in net cash expenditures (primarily severance), all of which has been paid as of September 30, 1997, and \$9,211,713 resulting from the write down of asset carrying values.

3 RECLASSIFICATION OF CERTAIN EXPENSES

Rebates to customers of \$2,681,742 for the year ended September 30, 1996 now reflected as a reduction of sales, were previously included in sales and marketing expenses. This reclassification had no impact on previously reported operating income or net income. Rebates to customers for the year ended September 30, 1995 were not significant.

In addition, certain costs relating to systems support and communications costs, which previously were included in general and administrative expenses, have been reclassified into sales and marketing and research and development expenses for all periods presented. Such amounts were \$2,647,207, \$2,707,024 and \$286,525 for the years ended September 30, 1997, 1996 and 1995, respectively. These reclassifications had no impact on previously reported operating income or net income.

4 ACQUISITIONS

On September 29, 1995, the Company acquired LAN Access Corporation ("LAN Access"), a provider of remote access products, for cash of approximately \$5.5 million, substantially all of which was allocated to goodwill. This acquisition was accounted for as a purchase. In connection with the restructuring plan adopted in 1997 (see Note 2), the Company sold the assets related to the LAN Access operations and wrote off all related goodwill.

5 INVESTMENT IN AETHERWORKS CORPORATION

During 1997 and 1996, under a note purchase agreement, the Company purchased \$6,500,000 and \$5,296,525, respectively, of convertible notes from AetherWorks Corporation, a development stage company engaged in the development of wireless and dial-up remote access technology. The convertible notes presently held by the Company at September 30, 1997 are convertible into 60% of AetherWorks' common stock. In connection with the financing arrangement, the Company has also guaranteed \$3,060,000 of lease obligations of AetherWorks. In addition, the Company has also leased to AetherWorks \$1,325,000 of computer equipment under a three-year direct financing lease.

For the years 1997 and 1996, the Company has reported its investment in AetherWorks on the equity method and has reported losses of \$5,764,201 and \$3,623,776, respectively. Such losses, which exclude \$5,758,548 of additional charges related to the AetherWorks investment, as described below, represent 100% of AetherWorks' net losses for the two years. The percentage of AetherWorks' net losses included in the Company's Statement of Operations was based upon the percentage of financial support provided by the Company (versus other investors) to AetherWorks during such years.

INVESTMENT IN AETHERWORKS CORPORATION

The following represents condensed financial information from the audited financial statements of AetherWorks for each of the years in the two-year period ended September 30, 1997:

BALANCE SHEET DATA, AS OF SEPTEMBER 30

	1997	1996
CURRENT ASSETS	\$ 955,695	\$ 104,307
FIXED ASSETS, NET	4,813,266	3,993,731
TOTAL ASSETS	5,578,887	4,407,779
CURRENT LIABILITIES	1,467,836	3,942,032
NOTES PAYABLE	16,016,747	6,105,467
STOCKHOLDERS' DEFICIT	(11,905,696)	(5,639,720)

OPERATING DATA FOR THE FISCAL YEAR ENDED SEPTEMBER 30

OPERATING EXPENSES:		
RESEARCH AND DEVELOPMENT	\$ 3,505,134	\$ 2,567,844
GENERAL AND ADMINISTRATIVE	2,069,304	999,247
OTHER	1,169,345	481,007
ELIMINATIONS	(979,582)	(424,322)
NET LOSS	\$ (5,764,201)	\$ (3,623,776)

On October 14, 1997, the Company entered into a revised note agreement with AetherWorks, that clarifies and limits the Company's financial commitment for the purchase of convertible notes to a maximum of \$13,800,000, which would result in the Company's ownership interest upon conversion of 62.7% based on AetherWorks' present capitalization. The revised note agreement, however, also provides for payments, at the discretion of AetherWorks, on the outstanding convertible notes of up to \$7,200,000 in exchange for a reduction in the Company's potential ownership interest, upon conversion, to 19%. The revised note agreement, among other things, rescinded previous technology transfer and manufacturing agreements with AetherWorks.

Because of the significant uncertainty of the future of AetherWorks Corporation, as demonstrated by its lack of ability to generate positive cash flow, obtaining other sources of equity financing and its continued uncertainty in developing commercially marketable products, the Company decided, as of September 30, 1997, to write off its remaining investment of \$2,408,500 in AetherWorks, and to accrue and expense its remaining future obligation to purchase additional notes of \$2,000,000. In addition, the Company has also accrued \$1,350,000 for its probable obligations resulting from its guarantees of certain AetherWorks' lease obligations.

6 SELECTED BALANCE SHEET AND STATEMENT OF CASH FLOWS DATA

	1997	1996

ACCOUNTS RECEIVABLE, NET:		
TRADE ACCOUNTS RECEIVABLE	\$ 26,838,275	\$ 43,610,340
LESS RESERVE FOR RETURNS AND DOUBTFUL ACCOUNTS	1,179,753	735,442
	-----	-----
	\$ 25,658,522	\$ 42,874,898

INVENTORIES, NET:		
RAW MATERIALS	\$ 10,160,377	\$ 19,145,019
WORK IN PROCESS	8,704,357	10,469,315
FINISHED GOODS	7,011,357	4,925,930
	-----	-----
	25,876,091	34,540,264
LESS RESERVE FOR OBSOLESCENCE	2,192,779	1,168,100
	-----	-----
	\$ 23,683,312	\$ 33,372,164

PROPERTY, EQUIPMENT AND IMPROVEMENTS:		
LAND	\$ 1,800,000	\$ 1,800,000
BUILDING	10,522,285	10,519,731
IMPROVEMENTS	629,240	631,362
EQUIPMENT	18,377,899	18,629,353
PURCHASED SOFTWARE	5,186,787	1,968,127
FURNITURE AND FIXTURES	927,859	1,899,928
	-----	-----
	37,444,070	35,448,501
LESS ACCUMULATED DEPRECIATION	13,826,374	11,218,400
	-----	-----
	\$ 23,617,696	\$ 24,230,101

INTANGIBLE ASSETS:		
PURCHASED TECHNOLOGY	\$ 910,859	\$ 1,672,850
LICENSE AGREEMENTS	1,133,900	1,174,908
COVENANTS NOT TO COMPETE		520,250
GOODWILL	6,364,242	11,185,506
OTHER	1,772,035	20,449
	-----	-----
	10,181,036	14,573,963
LESS ACCUMULATED AMORTIZATION	3,304,439	3,719,118
	-----	-----
	\$ 6,876,597	\$ 10,854,845

Supplemental disclosure of non-cash financing and investing information:

During fiscal 1997, the Company entered into a three-year direct financing lease agreement with a related party. In connection with this transaction, the Company has established a gross lease receivable of \$1,430,000 (see Note 5).

7 STOCK OPTIONS AND EMPLOYEE STOCK PURCHASE PLAN

The Company has a stock option plan (the "Plan") that provides for the issuance of nonstatutory stock options and incentive stock options (ISOs) to key employees and non-employee board members holding less than 5% of the outstanding shares of the Company's common stock.

The option price for ISOs and non-employee directors options is set at fair market value of the Company's common stock on the date of grant. The option price for nonstatutory options is set by the Compensation Committee of the Board of Directors. The authority to grant options and set other terms and conditions rests with the Compensation Committee. The Plan terminates in 2007.

DIGI INTERNATIONAL INC.

During the years ended September 30, 1997, 1996, and 1995, 50,106, 114,192, and 88,295 shares of the Company's Common Stock, respectively, were issued upon the exercise of options for 50,617, 123,959, and 95,367 shares, respectively. The difference between shares issued and options exercised results from the Plan's provision allowing employees to elect to pay their withholding obligation through share reduction. Withholding taxes paid by the Company as a result of the share withholding provision amounted to \$5,171 in 1997, \$186,927 in 1996, and \$413,000 in 1995.

During the year ended September 30, 1997, the Board of Directors authorized the cancellation and reissue of non-statutory stock options to certain employees for the purchase of 823,326 shares, at an exercise price below the market value of the stock. Under this authorization, the original option issues were canceled and new options were issued with a new four-year vesting schedule. During the years ended September 30, 1996 and 1995, the Board of Directors authorized the issuance of nonstatutory stock options for the purchase of 2,500 and 50,000 shares, respectively, at prices below the market value of the stock on the grant dates. The difference between the option price and market value at the date of grant for the above option arrangements has been recorded as additional paid-in capital with an offsetting debit within stockholders' equity to unearned stock compensation. The compensation expense related to these option grants is amortized to operations over the five-year vesting period in which the employees perform services and amounted to \$244,569 in 1997, \$204,793 in 1996, and \$166,667 in 1995.

Stock options and common shares reserved for grant under the plan are as follows:

STOCK OPTIONS

	AVAILABLE FOR GRANT	OUTSTANDING	OPTIONS WEIGHTED AVERAGE PRICE PER SHARE

BALANCES, SEPTEMBER 30, 1994	7,162	903,338	\$ 13.30
ADDITIONAL SHARES APPROVED FOR GRANT			
GRANTED	2,000,000		
EXERCISED	(808,375)	808,375	18.74
CANCELLED		(95,367)	9.06
	119,251	(119,251)	15.33

BALANCES, SEPTEMBER 30, 1995	1,318,038	1,497,095	\$ 16.41
GRANTED	(1,186,525)	1,186,525	20.67
EXERCISED		(123,959)	11.38
CANCELLED	223,001	(223,001)	22.18

BALANCES, SEPTEMBER 30, 1996	354,514	2,336,660	\$ 18.14
ADDITIONAL SHARES APPROVED FOR GRANT			
GRANTED	500,000		
EXERCISED	(1,509,701)	1,509,701	8.62
CANCELLED		(50,617)	7.71
	1,894,636	(1,894,636)	19.01

BALANCES, SEPTEMBER 30, 1997	1,239,449	1,901,108	\$ 10.01

Commencing in April 1996, the Company has sponsored an Employee Stock Purchase Plan which covers all domestic employees with at least 90 days of service. The plan allows eligible participants the right to purchase common stock on a quarterly basis at the lower of 85% of the market price at the beginning or end of each three month offering period. Employee contributions to the plan were \$534,327 and \$200,888 for the fiscal years 1997 and 1996, respectively. Pursuant to the plan, 69,402 and 8,835 shares were issued to employees during fiscal years 1997 and 1996, respectively. As of September 30, 1997, 421,763 shares are available for future issuances.

DIGI INTERNATIONAL INC.

8 STOCK-BASED COMPENSATION

In accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123), the Company has chosen to continue to account for stock-based compensation using the intrinsic value method.

Had the Company used the fair-value-based method of accounting for its stock options granted in 1997 and 1996, and charged operations over the option vesting periods based on the fair value of options at the date of grant, net (loss) income and net (loss) income per common share would have been reduced to the following pro forma amounts:

	1997	1996
NET (LOSS) INCOME		
AS REPORTED	\$ (15,790,844)	\$ 9,300,220
PRO FORMA	(17,449,611)	8,536,111
NET (LOSS) INCOME PER SHARE		
AS REPORTED	\$ (1.18)	\$.69
PRO FORMA	(1.30)	.63

The pro forma information presented includes only stock options granted in fiscal years 1997 and 1996. Compensation expense, under the fair-value-based method, will increase over the next few years as additional stock option grants are considered.

The weighted average fair value of options granted in fiscal years 1997 and 1996 was \$8.57 and \$20.67, respectively. The weighted average fair value was determined based upon the fair value of each option on the grant date, utilizing the Black-Scholes option-pricing model and the following assumptions:

	1997	1996
RISK-FREE INTEREST RATE	6.02%	5.99%
EXPECTED OPTION HOLDING PERIOD	4 YEARS	4 YEARS
EXPECTED VOLATILITY	40%	50%
EXPECTED DIVIDEND YIELD	0	0

At September 30, 1997, the weighted average exercise price and remaining life of the stock options are as follows:

RANGE OF EXERCISE PRICES	\$.50-10.75	\$11.25-17.50	\$19.25-29.25	TOTAL
TOTAL OPTIONS OUTSTANDING	1,472,398	259,335	169,375	1,901,108
WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	6.21	6.42	6.90	6.51
WEIGHTED AVERAGE EXERCISE PRICE	\$7.92	\$13.44	\$22.84	\$10.01
OPTIONS EXERCISABLE	86,438	181,840	141,825	410,103
WEIGHTED AVERAGE PRICE OF EXERCISABLE OPTIONS	\$5.45	\$13.71	\$22.82	\$13.99

9 LINE OF CREDIT

During 1996, the Company negotiated a \$5 million uncollateralized line of credit with its bank, to be used to fund general corporate cash needs. The interest rate varies depending on the "base" or "prime" rate established by the bank. During fiscal 1997 and 1996, the Company did not use this line of credit.

10 COMMITMENTS

The Company has entered into various operating lease agreements, the last of which expires in fiscal year 2002. Below is a schedule of future minimum commitments under noncancelable operating leases:

FISCAL YEAR	AMOUNT
1998	\$835,142
1999	591,358
2000	576,377
2001	491,990
2002	280,510

Total rental expense for all operating leases for the years ended September 30, 1997, 1996 and 1995 was \$1,405,582, \$965,710 and \$946,000, respectively.

11 INCOME TAXES

The components of the provision for income taxes for the years ended September 30, 1997, 1996 and 1995 are as follows:

	1997	1996	1995

CURRENT PAYABLE:			
FEDERAL	\$ 1,737,116	\$ 6,977,337	\$ 9,505,650
STATE	142,457	920,956	614,100
DEFERRED	(1,787,933)	(393,153)	(84,750)
	-----	-----	-----
	\$ 91,640	\$ 7,505,140	\$ 10,035,000
	-----	-----	-----

The net deferred tax asset at September 30, 1997 and 1996 consists of the following:

	1997	1996

VALUATION RESERVES	\$ 1,791,903	\$ 615,631
INVENTORY VALUATION	800,364	432,225
VACATION COSTS	197,107	311,250
DEPRECIATION	193,525	(164,850)
	-----	-----
NET DEFERRED TAX ASSET	\$ 2,982,899	\$ 1,194,256
	-----	-----

The reconciliation of the federal statutory income tax rate to the effective income tax rate for the years ended September 30, 1997, 1996 and 1995, are as follows:

	1997	1996	1995

STATUTORY INCOME TAX RATE	(34.0)%	35.0%	35.0%
INCREASE (REDUCTION) RESULTING FROM:			
UTILIZATION OF RESEARCH AND DEVELOPMENT TAX CREDITS	(0.9)	(1.7)	(1.7)
STATE TAXES, NET OF FEDERAL BENEFITS	1.0	3.6	2.5
AETHERWORKS CORPORATION NET OPERATING LOSS	12.5	8.0	
AETHERWORKS CORPORATION WRITE OFF	9.6		
RESTRUCTURING CHARGE	9.3		
TAX CONTINGENCY	4.7		
FOREIGN AND OTHER	(2.1)	(0.2)	(1.6)
	-----	-----	-----
	.1%	44.7%	34.2%
	-----	-----	-----

12 FOREIGN SALES AND MAJOR CUSTOMERS

The Company maintains foreign sales offices but does not otherwise have any foreign operations. Foreign export sales, primarily to Europe, comprised approximately 23.9%, 20%, and 20% of net sales for the years ended September 30, 1997, 1996 and 1995, respectively.

During 1997, one customer (customer A) accounted for 15.1% of net sales while another (customer B) accounted for 10.5% of net sales. In addition, customer A accounted for 28% of the trade accounts receivable outstanding at September 30, 1997.

During 1996, one customer (customer B) accounted for 13.9% of net sales and 11.8% of accounts receivable at September 30, 1996, while another (customer A) accounted for 13.4% of net sales and 14.3% of accounts receivable at September 30, 1996. During 1995, one customer (customer A) accounted for 12.5% of net sales and another customer (customer C) accounted for 11.7%.

13 EMPLOYEE BENEFIT PLAN

The Company has a savings and profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code ("the Code"), whereby eligible employees may contribute up to 15% of their earnings, not to exceed amounts allowed under the Code. In addition, the Company may make contributions at the discretion of the Board of Directors. No Company contribution was made in 1997 or 1996. During 1995, the Company provided for matching contributions totaling \$125,000.

14 CONTINGENCIES

During fiscal 1997, the Company and certain of its previous officers were named as defendants in a series of putative securities class action lawsuits in the United States District Court for the District of Minnesota on behalf of an alleged class of purchasers of its common stock during the period January 25, 1996 through December 23, 1996, inclusive, which were consolidated, and a Consolidated Amended Complaint was filed in May 1997. Also in 1997, a similar, but separate action was filed by the Louisiana State Employees Retirement System. The Consolidated Amended Complaint and the Louisiana Complaint allege the Company and certain of its previous officers violated federal securities laws by, among other things, misrepresenting and/or omitting material information concerning the Company's operations and financial results. The Louisiana Complaint also alleges misrepresentations in violation of state common law.

The defendants served motions to dismiss the Consolidated Amended Complaint and the Louisiana Complaint on the ground, among others, that they fail to plead claims in accordance with applicable law. The motions were argued before the District Court at a hearing on October 31, 1997. No ruling has been received as of December 15, 1997.

Because the lawsuits are in their preliminary stages, the ultimate outcomes cannot be determined at this time, and no potential assessment of the probable or possible effects of such litigation, if any, on the Company's financial position, liquidity or future operations can be made.

REPORT OF MANAGEMENT

TO THE STOCKHOLDERS OF DIGI INTERNATIONAL INC.:

The Company's management is responsible for the integrity, objectivity and consistency of the financial information presented in this annual report. The consolidated financial statements contained herein were prepared in accordance with generally accepted accounting principles and were based on informed judgments and management's best estimates as required. Financial information elsewhere in this annual report is consistent with that contained in the consolidated financial statements.

The Company maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded, transactions are properly executed in accordance with management's authorization, and accounting records may be relied upon for the preparation of financial statements and other financial information. The system is monitored by direct management review. Limitations exist in any system of internal control, based upon the recognition that the cost of the system should not exceed the benefits derived.

The Company's consolidated financial statements have been audited by Coopers & Lybrand L.L.P., independent certified public accountants. Their audits were conducted in accordance with generally accepted auditing standards. As part of their audits of the Company's consolidated financial statements, these independent accountants considered the Company's internal controls to the extent they deemed necessary to determine the nature, timing and extent of their audit tests.

The Audit Committee of the Board of Directors is composed entirely of non-employee directors and is responsible for monitoring and overseeing the quality of the Company's accounting and reporting policies, internal controls and other matters deemed appropriate. The independent certified public accountants have free access to the Audit Committee without management present.

/s/ Jerry Dusa

Jerry A. Dusa
President and Chief Executive Officer

/s/ Jonathon E. Killmer

Jonathon E. Killmer
Senior Vice President, Chief Financial Officer and Treasurer

REPORT OF INDEPENDENT ACCOUNTANTS

TO THE STOCKHOLDERS AND BOARD OF DIRECTORS OF
DIGI INTERNATIONAL INC.:

We have audited the consolidated balance sheets of Digi International Inc. and subsidiaries as of September 30, 1997 and 1996, and the related consolidated statements of operations, cash flows and stockholders' equity for each of the three years in the period ended September 30, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. As discussed in Note 5, the Company has recorded its investment in AetherWorks Corporation (AetherWorks) on the equity method; the 1997 and 1996 consolidated statements of operations include AetherWorks' net operating losses for the years ended September 30, 1997 and 1996 of \$5,764,201 and \$3,623,776, respectively. We did not audit the financial statements of AetherWorks, which statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for AetherWorks' net operating losses, is based solely on the report of other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors for the years ended September 30, 1997 and 1996, provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors for the years ended September 30, 1997 and 1996, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Digi International Inc. and subsidiaries as of September 30, 1997 and 1996, and the consolidated results of their operations and their cash flows for each of the three years in the period ended September 30, 1997, in conformity with generally accepted accounting principles.

/s/ Coopers & Lybrand L.L.P.

Coopers & Lybrand L.L.P.

DIGI INTERNATIONAL INC.

QUARTERLY FINANCIAL DATA (UNAUDITED):

	QUARTER ENDED			
	DEC. 31	MAR. 31	JUNE 30	SEPT. 30

1997				
NET SALES	\$ 42,236	\$ 40,393	\$ 40,843	\$ 42,125
GROSS MARGIN	19,640	19,294	20,118	21,063
RESTRUCTURING		(10,471)		
AETHERWORKS CORPORATION NET LOSS	(1,520)	(1,590)	(1,525)	(1,130)
AETHERWORKS CORPORATION WRITE OFF				(5,759)
NET (LOSS) INCOME	(2,578)	(9,400)	67	(3,880)
NET (LOSS) INCOME PER SHARE	(.19)	(.70)	.01	(.29)
1996				
NET SALES	\$ 43,716(A)	\$ 47,973(A)	\$ 49,643(A)	\$ 51,819(A)
GROSS MARGIN	23,729(A)	25,391(A)	24,451(A)	26,471(A)
AETHERWORKS CORPORATION NET LOSS	(279)	(656)	(1,204)	(1,485)
NET (LOSS) INCOME	4,522	4,620	(51)	209
NET INCOME PER SHARE	.33	.34	.0	.02
1995				
NET SALES	\$ 37,879	\$ 40,076	\$ 41,179	\$ 45,844
GROSS MARGIN	19,745	21,169	22,131	23,000
NET INCOME	4,491	4,597	4,847	5,396
NET INCOME PER SHARE	.32	.33	.35	.38

THE SUMMATION OF QUARTERLY NET INCOME PER SHARE MAY NOT EQUATE TO THE YEAR-END CALCULATION AS QUARTERLY CALCULATIONS ARE PERFORMED ON A DISCRETE BASIS.

(A) RESTATED FOR THE RECLASSIFICATION OF REBATES.

Subsidiaries of Registrant

Digi International Asia Pte., Ltd.
Digi International GmbH
DigiBoard Incorporated FSC
Digi International Israel Inc.
Digi International (HK) Ltd.
Digi International Australia PTY Ltd.
Digi International Limited
Digi International SARL

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the Form S-8 registration statements (File No. 33-32956, File No. 33-38898, File No. 333-99 and File No. 333-23857) of Digi International Inc. for its Stock Option Plan; and, Form S-8 (File No. 333-1821) of Digi International Inc. for its Employee Stock Purchase Plan of our reports dated December 15, 1997, on our audits of the consolidated financial statements and financial statement schedule of Digi International Inc. as of September 30, 1997 and 1996, and for the years ended September 30, 1997, 1996 and 1995, which reports are included in or incorporated by reference in this Annual Report on Form 10-K.

/s/ COOPERS AND LYBRAND L.L.P.

Minneapolis, Minnesota
December 26, 1997

EXHIBIT 23.2

CONSENT OF INDEPENDENT ACCOUNTANTS

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the Form S-8 registration statements (File No. 33-32956, File No. 33-38898, File No. 333-99 and File No. 333-23857) of Digi International Inc. for its Stock Option Plan; Form S-3 Registration Statement (File No. 33-59223) of Digi International Inc. for the common shares issued as part of the MiLAN Technologies acquisition; and Form S-8 (File No. 333-1821) of Digi International Inc. for its Employee Stock Purchase Plan of our report dated October 28, 1997, with respect to the financial statements of AetherWorks Corporation for the years ended September 30, 1997 and 1996, and the period from February 24, 1993 (inception) to September 30, 1997 included in the Annual Report (Form 10-K) of Digi International Inc. for the year ended September 30, 1997 filed with the Securities and Exchange Commission.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
December 24, 1997

EXHIBIT 24
POWERS OF ATTORNEY

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Jerry A. Dusa and Jonathon E. Killmer, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 8th day of December, 1997.

/s/ John P. Schinas

John P. Schinas

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Jerry A. Dusa and Jonathon E. Killmer, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 7th day of December, 1997.

/s/ Robert S. Moe

Robert S. Moe

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Jerry A. Dusa and Jonathon E. Killmer, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 5th day of December, 1997.

/s/ Willis K. Drake

Willis K. Drake

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Jerry A. Dusa and Jonathon E. Killmer, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 8th day of December, 1997.

/s/ David Stanley

David Stanley

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Jerry A. Dusa and Jonathon E. Killmer, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 8th day of December, 1997.

/s/ Richard E. Eichhorn

Richard E. Eichhorn

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Jerry A. Dusa and Jonathon E. Killmer, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 8th day of December, 1997.

/s/ Mykola Moroz

Mykola Moroz

YEAR		
	SEP-30-1997	
	OCT-01-1996	
	SEP-30-1997	
		31,329,666
		0
		25,658,522
		0
		23,683,312
		84,819,442
		23,617,696
		0
		118,311,336
	22,840,305	
		0
		0
		147,273
		95,323,758
118,311,336		
		165,597,937
	165,597,937	
		85,482,536
		73,974,183
		21,994,231
		0
		0
		(15,699,204)
		91,640
	(15,790,844)	
		0
		0
		0
		(15,790,844)
		(1.18)
		(1.18)

Includes reserve for investment in AetherWorks Corp. of \$3,350,000.
AetherWorks loss 5,764,201, Write-off investment AetherWorks 5,758,548, Restructuring 10,471,482.