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

FORM 10-K

(Mark one)

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

For the fiscal year ended: September 30, 1998

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. [X]

The aggregate market value of voting stock held by nonaffiliates of the Registrant, based on a closing price of $10.188 per share as reported on the National Association of Securities Dealers Automated Quotation System-National Market System on December 11, 1998 was $133,119,994.

Shares of common stock outstanding as of December 11, 1998: 14,588,995

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, 1998 and Proxy Statement for the Registrant's Annual Meeting of Stockholders scheduled for January 27, 1998, a definitive copy of which will be filed on or about January 11, 1999. All such information set forth below under the heading "Reference" is incorporated herein by reference, or included in this Form 10-K on the pages indicated.

PART I	ITEM IN FORM 10-K	REFERENCE
Item 1.	Business	Business, pages 4 through 7, this document; Note 1, Notes to Consolidated Financial Statements Annual Report to Stockholders
Item 2.	Properties	Properties, pages 7 and 8, this document
Item 3.	Legal Proceedings	Legal Proceedings, pages 8 and 9, this document
Item 4.	Submission of Matters to a Vote of Security Holders	Submission of Matters to a Vote of Security Holders, page 9, this document
PART II		
Item 5.	Market for Registrant's Common Equity and Related Stockholder Matters	Stock Listing; Dividend Policy, page 40, Annual Report to Stockholders
Item 6.	Selected Financial Data	Financial Highlights, page 2, Annual Report to Stockholders; Selected Financial Information, page 17, 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 17 through 24, Annual Report to Stockholders
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	Quantitative and Qualitative Disclosures About Market Risk, page 9, this document

Item 8.	Financial Statements and Supplementary Data	Annual Report to Stockholders, pages 25 through 39
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	Changes and Disagreements with Accountants on Accounting and Financial Disclosure, page 9, 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 9 and 10, 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 Fiscal 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	Not applicable

PART IV

Item 14.	Exhibits, Financial Statement Schedules and Reports on Form 8-K	Exhibits, Financial Statement Schedules and Reports on Form 8-K, pages 10 through 13, this document

PART I

ITEM 1. BUSINESS

Digi International Inc. ("Digi" or the "Company") was formed in l985 as a Minnesota corporation and reorganized as a Delaware corporation in l989. The Company is a worldwide provider of data communications products for open systems, server-based remote access, and local area network ("LAN") applications. Digi's communications products, which support a broad range of server platforms and network operating systems in the industry, enable people to have access to information, no matter when they need it, or what type of computer they are using.

Digi's products enhance the development of open systems, server-based communication by being compatible with all PC platforms - Compaq, IBM, Hewlett-Packard, and Sun Microsystems - and popular operating systems, including Microsoft Windows NT and Novell NetWare. Digi's solutions give customers the flexibility to scale up easily as needs change and to choose from a variety of industry-standard, cost effective alternatives. Digi's products also support remote access connectivity through intranets and the Internet.

The Company's server-based communications serial port boards 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 serial port communications products constituted approximately 80%, 76% and 80% of net sales in fiscal 1998, 1997 and 1996, respectively. These products provide connections for two primary markets:

1. The core serial port products provide PC-host-to-terminal serial I/O (input/output) connections. These products facilitate data transmission for point-of-sale ("POS") applications, on-line transaction processing, factory automation, inventory control and office automation, 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 communications cards.

2. Open systems, server-based remote access products are data communications boards that support remote access applications such as Internet access, connectivity to corporate intranets and branch office networks, and telecommuting.

The Company entered the LAN market with its acquisition of MiLAN Technology Corporation in November 1993. The Company's LAN business, formerly 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 connectivity products include these two groups:

1. The physical layer products allow users to easily build and expand networks using a variety of technologies including Ethernet, Fast Ethernet, Gigabit Ethernet and ATM. These products include single and multiport transceivers, converters, microhubs and modular repeaters.

2. The print server products, based on the FastPort line, make 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 entered the Internet telephony market with the acquisition of ITK International, Inc. ("ITK International") in July of 1998 and its Voice over Internet Protocol ("VoIP") technology. ITK International provides the new VoIP technology with the NetBlazer 8500 gateway, a "proof of concept" product that converts voice signals to TCP/IP packets and routes them over IP networks such as the Internet and company intranets. This capability combines voice and data onto one cost-effective network and is changing the whole concept of traditional voice communication. Although the VoIP technology acquired from ITK International is still under development, the Company believes that this technology will be successful once a functioning, finished product is complete. Digi acquired ITK International for approximately $27.7 million in cash, stock, replacement stock options and the assumption of $39.8 million of liabilities and restructuring/integration costs.

The Company expanded its product lines with its acquisition of Central Data Corporation ("Central Data") in July 1998. The Company also acquired in-process research and development from Central Data related to Universal Serial Bus (USB) technology. This in-process technology will give customers the ability to maintain existing non-USB peripheral equipment and connect with new PCs which contain advanced USB interfaces. The Company expects to introduce USB products in fiscal 1999. Digi acquired Central Data for approximately $19.2 million in cash, stock, replacement stock options and the assumption of $4.4 million of liabilities and restructuring/integration costs.

The Company works closely with customers, PC and server vendors, operating system companies and other marketing partners to continuously optimize Digi's wide area network ("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, end users, system integrators, VARs and OEMs. This network includes more than 185 distributors in the United States, Canada and 65 countries worldwide, as well as OEM customers.

In July 1991, the Company opened a sales support office in Germany to increase sales support to the European distribution network. The Company expanded its presence in the

German market in July 1998 with the acquisition of ITK International, which maintains a sales and manufacturing office in Dortmund, Germany. 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 systems 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 serial port boards for server-based communications in the computer industry. With respect to the LAN business, the Company believes it commands less than a 5% market share. The Company is currently establishing its position in the remote access market for the Company's RAS product lines. The Company will enter the Internet telephony market upon full development of its VoIP technology.

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. Most of these components are available from multiple vendors. The Company does have several single-sourced supplier relationships, either because alternative sources are not available or because the relationship is advantageous to the Company. If these suppliers are unable to provide timely and reliable supply of components, the Company could experience manufacturing delays adversely affecting its results of operations.

During fiscal years 1996, 1997 and 1998, the Company's research and development expenditures were $21.3, $18.0, and $17.0 million, respectively.

Due to 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.

In May 1998, the Company exchanged its previously purchased $13,796,525 of convertible notes from AetherWorks Corporation, a development stage company engaged in the development of wireless and dial-up remote access technology, for a non-interest bearing $8,000,000 non-convertible note. As a part of the exchange, the Company relinquished its rights to any future technology or claims on any of AetherWorks' intellectual properties. In exchange, the Company has been released from all of its guarantees of certain lease obligations of AetherWorks. As a result, the Company has reversed its $1,350,000 accruals established in the fourth quarter of 1997, for the estimated probable cost related to its guarantee of such lease obligations and has included such amount as AetherWorks Corporation gain for the year ended September 30, 1998.

Due to the significant uncertainty as to collectibility of the $8,000,000 note, which matures in 2001, the note has been recorded with no carrying value as of September 30, 1998. The Company continues to lease to AetherWorks $1,325,000 of computer equipment under a three-year direct financing lease, expiring in 2000.

During the year ended September 30, 1998, two customers comprised more than 10% of net sales each: Ingram Micro at 15.5% and Tech Data at 13.7% . During the year ended September 30, 1997, two customers comprised more than 10% of net sales each: Ingram Micro at 15.1%, and Tech Data at 10.5%. During the year ended September 30, 1996, two customers accounted for more than 10% of net sales each: Tech Data at 13.9% and Ingram Micro at 13.4%.

As of September 30, 1998, the Company had backlog orders which management believed to be firm in the amount of $2.9 million. All of these orders are expected to be filled in the current fiscal year. Backlog as of September 30, 1997 was $14.7 million.

Total employees at September 30, 1998 were 703.

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. The headquarters and research facilities owned by ITK International are located in a 63,000 square foot facility in Dortmund, Germany. The headquarters and research facility owned by Central Data are located in a 20,000 square foot facility located in Champaign, Illinois.

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 886 square foot office in Sydney, the lease for which expires in February 2001. The Company's sales support office in Hong Kong is located in a 2,643

square foot office in Causeway Bay, the lease for which expires in 2001. 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

Between January 3, 1997 and March 7, 1997, the Company and certain of its previous officers were named as defendants in five putative securities class action lawsuits filed in the United States District Court for the District of Minnesota on behalf of an alleged class of purchasers for its common stock during the period January 25, 1996, through December 23, 1996. The five putative class actions were thereafter consolidated, and on May 12, 1997, a consolidated amended class action complaint (the "Consolidated Amended Complaint") was filed in the actions, which are captioned IN RE DIGI INTERNATIONAL INC. SECURITIES LITIGATION (Master File No. 97-5 DWF/RLE). 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 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, which is captioned LOUISIANA STATE EMPLOYEES RETIREMENT SYSTEM V. DIGI INTERNATIONAL INC., GARY L. DEANER, ERVIN F. KAMM, JR., GERALD A. WALL AND "JOHN DOE" AND "RICHARD ROE", DEFENDANTS (Civil File No. 97-440, Master File No. 97-5 DWF/RLE). 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.

In a decision issued on May 22, 1998, the United States District Court for the District of Minnesota granted in part and denied in part defendants' motions to dismiss the Consolidated Amended Complaint and the Louisiana Amended Complaint. The Court dismissed without leave to replead all claims asserted in both cases, except for certain federal securities law claims based upon alleged misrepresentation and/or omissions relating to the accounting treatment applied to the Company's AetherWorks investment. The Court also limited the claims asserted in the Louisiana Amended Complaint to the

11,000 shares of the Company's stock held subsequent to November 14, 1996, for which the Louisiana Amended Complaint claims damages of $184,276.40. The claims in the two actions remain pending against the Company and its former officers Ervin F. Kamm, Jr. and Gerald A. Wall. Discovery in the actions is proceeding.

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

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, 1998.

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
Jerry A. Dusa	51	Director, President and Chief Executive Officer
Douglas J. Glader	55	Senior Vice President, Manufacturing Operations
Dino G. Kasdagly	44	Senior Vice President, Development

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. Glader was named Vice President of Operations in February 1995 and Senior Vice President, Manufacturing Operations, on April 23, 1997. Before that, he was 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 8-K

(a) Consolidated Financial Statements and Schedules of the Company and Report of Independent Auditors for AetherWorks Corporation

1. Incorporated by reference to pages 25 through 38 of the Company's 1998 Annual Report to Stockholders:

   Consolidated Statements of Operations for the fiscal years ended September 30, 1998, 1997 and 1996

   Consolidated Balance Sheets as of September 30, 1998 and 1997

   Consolidated Statements of Cash Flows for the fiscal years ended September 30, 1998, 1997 and 1996

   Consolidated Statements of Stockholders' Equity for the fiscal years ended September 30, 1998, 1997 and 1996

   Notes to Consolidated Financial Statements

   Report of Independent Accountants

2. All financial statement schedules are omitted because they are not applicable or are not required.

3. Report of Ernst & Young LLP, Independent Auditors for AetherWorks Corporation

(b) Reports on Form 8-K

Form 8-K dated July 23, 1998, regarding the Company's acquisition of Central Data Corporation on July 8, 1998.

Form 8-K dated August 12, 1998, regarding the Company's acquisition of ITK International, Inc. on July 29, 1998.

Form 8-K dated September 4, 1998, regarding the authorization of the Company to purchase up to 1 million shares of its Common Stock and the resignation of Jonathan E. Killmer, Senior Vice President, Chief Financial Officer and Treasurer, effective October 30, 1998.

Form 8-K dated September 11, 1998, regarding the write-off and restructuring charge associated with the acquisition of Central Data Corporation and ITK International, Inc. in the fourth quarter of fiscal 1998.

(c) Exhibits

Exhibit Number	Description
2(a)	Agreement and Plan of Merger dated as of July 1, 1998 among the Company, Iroquois Acquisition Inc. and ITK International, Inc. (1)
2(b)	Agreement and Plan of Merger dated as of July 1, 1998 among the Company, CD Acquisition Inc. and Central Data Corporation (2)
3(a)	Restated Certificate of Incorporation of the Company (3)
3(b)	Amended and Restated By-Laws of the Company (4)
10(a)	Stock Option Plan of the Company
10(b)	Form of indemnification agreement with directors and officers of the Company (5)
10(c)	Amended and Restated Employment Agreement between the Company and John P. Schinas (6)
10(d)	Restated and Amended Note Purchase Agreement between the Company and AetherWorks Corporation, dated October 14, 1997 (7)
10(e)	401(k) Savings and Profit Sharing Plan of Digi International Inc. (8)

10(f) Employment Arrangement between the Company and Jonathon E. Killmer, dated September 16, 1996 (9)

10(g) Employment Agreement between the Company and Jerry A. Dusa, dated March 12, 1997 (10)

10(h) Employment Arrangement between the Company and Douglas Glader (11)

10(h) (i) Amendment to Employment Agreement between the Company and Douglas Glader (12)

10(i) Employment Agreement between the Company and Dino G. Kasdagly, dated October 1, 1997 (13)

10(j) Employee Stock Purchase Plan of the Company (14)

13 1998 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 Company

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 Exhibit 2 to the Company's Form 8-K filed August 12, 1998 (File no. 0-17972).

(2) Incorporated by reference to Exhibit 2 to the Company's Form 8-K filed July 23, 1998 (File no. 0-17972).

(3) Incorporated by reference to Exhibit 3(a) to the Company's Form 10-K for the year ended September 30, 1993 (File no. 0-17972).

(4) Incorporated by reference to Exhibit 3(b) to the Company's Registration Statement on Form S-1 (File no. 33-42384).

(5) Incorporated by reference to Exhibit 10(b) to the Company's Registration Statement on Form S-1 (File no. 33-30725).

(6) Incorporated by reference to Exhibit 10(c) to the Company's Form 10-K for the year ended September 30, 1994 (File no. 0-17972).

(7) Incorporated by reference to Exhibit 10(d) to the Company's Form 10-K for the year ended September 30, 1997 (File no. 0-17972).

(8) Incorporated by reference to Exhibit 10(f) to Company's Form 10-K for the year ended September 30, 1991 (File no. 0-17972).

(9) Incorporated by reference to Exhibit 10(k) to the Company's Form 10-K/A for the year ended September 30, 1996 (File no. 0-17972).

(10) Incorporated by reference to Exhibit 10(m) to the Company's Form 10-Q for the quarter ended March 31, 1997 (File no. 0-17972).

(11) Incorporated by reference to Exhibit 10(q) to the Company's Form 10-K for the year ended September 30, 1995 (File no. 0-17972).

(12) Incorporated by reference to Exhibit 10(p) to the Company's Form 10-Q for the quarter ended December 31, 1996 (File no. 0-17972).

(13) Incorporated by reference to Exhibit 10(r) to the Company's Form 10-K for the year ended September 30, 1997 (File no. 0-17972).

(14) Incorporated by reference to Exhibit B to the Company's Proxy Statement for its Annual Meeting of Stockholders held on January 31, 1996.

Report of Independent Auditors

Board of Directors and Shareholders
AetherWorks Corporation

We have audited the 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, not separately presented herein, 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 financial statements referred to above 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

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 29, 1998	By:	/s/ Jerry A. Dusa
Date		Jerry A. Dusa President & Chief Executive 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 29, 1998	/s/ Jerry A. Dusa
Date	Jerry A. Dusa President & Chief Executive Officer (Principal Executive Officer)
December 29, 1998	/s/ William C. Nolte
Date	William C. Nolte Director of Finance and Controller (Acting Principal Financial and Accounting Officer)

JOHN P. SCHINAS
WILLIS K. DRAKE
JERRY A. DUSA
RICHARD E. EICHHORN
MYKOLA MOROZ — A majority of the Board of Directors*
DAVID STANLEY
ROBERT S. MOE

Jerry A. Dusa, by signing his name hereto, does hereby sign this document on behalf of himself and each of the other above named directors of the Registrant pursuant to Powers of Attorney duly executed by such persons.

/s/ Jerry A. Dusa

Jerry A. Dusa,
Attorney-in-fact

EXHIBIT INDEX

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3(a)	Restated Certificate of Incorporation of the Registrant, as amended	Incorporated by Reference
3(b)	Amended and Restated By-Laws of the Registrant	Incorporated by Reference
10(a)	Stock Option Plan of the Registrant	Filed Electronically
10(b)	Form of indemnification agreement with directors and officers of the Registrant	Incorporated by Reference
10(c)	Amended and Restated Employment Agreement between the Registrant and John P. Schinas	Incorporated by Reference
10(d)	Restated and Amended Note Purchase Agreement between the Registrant and Aether Works Corporation, dated October 14, 1997	Incorporated by Reference
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10(h)	(i) Amendment to Employment Agreement between the Registrant and Douglas Glader	Incorporated by Reference
10(i)	Employment Agreement between the Registrant and Dino G. Kasdagly, dated October 1, 1997	Incorporated by Reference
10(j)	Employee Stock Purchase Plan of the Registrant	Incorporated by Reference
23.1	Consent of Independent Accountants	Filed Electronically
23.2	Consent of Independent Accountants	Filed Electronically
24	Powers of Attorney	Filed Electronically
27	Financial Data Schedule	Filed Electronically

EXHIBIT 10(a)

DIGI INTERNATIONAL INC.

STOCK OPTION PLAN
AS AMENDED AND RESTATED
AS OF JULY 28, 1998

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 Nasdaq Stock Market or any similar system then in use or, if such shares are not included on the Nasdaq Stock Market 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 an NASD 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 elected to be an Outside Director 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)(i). The number of Common Shares covered by each such option shall be 5,000;

(ii) each person who is an Outside Director at the conclusion of an 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 shall also be the date of grant for options granted pursuant to this subparagraph 6(a)(ii). The number of Common Shares covered by each such option shall be 1,500;

(iii) each person who is elected to be an Outside Director between Annual Meetings 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)(iii). 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;

(iv) each person who is an Outside Director at the conclusion of an Annual Meeting of Stockholders 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)(iv). 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

(v) each person who is elected to be an Outside Director between Annual Meetings 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)(v). 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(d) and 6(e) hereof, (x) options granted to Outside Directors pursuant to subparagraph 6(a)(ii) and (iv) and (y) options granted to Outside Directors pursuant to subparagraph 6(a)(i) 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%

(ii) Subject to the provisions of paragraph 6(d) and 6(e) hereof, (x) the options granted to Outside Directors pursuant to subparagraphs 6(a)(iii) and (v) and (y) options granted to Outside Directors pursuant to subparagraph 6(a)(i) 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 vesting schedules set forth in paragraph 6(c) 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.

(e) 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;

(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. Provided, however, that a person exercising a stock option shall not be permitted to pay any portion of the purchase price with stock if, in the opinion of the Committee, payment in such manner could have adverse financial accounting consequences for the Company. 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) unless otherwise provided in a stock option agreement, 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, unless otherwise provided in a stock option agreement, only to the extent that the option was exercisable immediately prior to such optionee's termination of employment, and unless otherwise provided in a stock option agreement, 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, unless otherwise provided in a stock option agreement, 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; or

(d) 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 July 26, 1989.

SELECTED FINANCIAL INFORMATION >>

	1998	1997	1996	1995	1994
Net sales	$182,932	$165,598	$193,151	$164,978	$130,945
Percentage increase (decrease)	10.5%	(14.3)%	17.1%	26.0%	40.2%
Net (loss) income	(22,659)	(15,791)	9,300	19,331	16,701
Percentage increase (decrease)	(43.5)%	(269.8)%	(51.9)%	15.7%	12.0%
Net (loss) income per share - basic	(1.65)	(1.18)	0.70	1.42	1.17
Percentage increase (decrease)	(39.8)%	(268.6)%	(50.7)%	(21.4)%	13.6%
Net (loss) income per share - assuming dilution	(1.65)	(1.18)	0.68	1.39	1.16
Percentage increase (decrease)	(39.8)%	(268.6)%	(51.1)%	19.8%	13.6%
Total assets	160,735	118,311	129,939	126,043	102,758
Percentage increase (decrease)	35.8%	(8.9)%	3.1%	22.7%	15.6%
Long-term debt	11,124				
Stockholders' equity	94,821	95,471	109,943	105,827	91,113
Percentage increase (decrease)	(0.7)%	(13.2)%	3.9%	16.1%	13.2%

(IN THOUSANDS EXCEPT PER SHARE AMOUNTS AND PERCENTAGES)

MANAGEMENT'S DISCUSSION AND ANALYSIS >>

RESULTS OF OPERATIONS >>

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

	YEAR ENDED SEPTEMBER 30,			PERCENTAGE INCREASE/(DECREASE)	
	1998	1997	1996	1998 OVER 1997	1997 OVER 1996
Net sales	100.0%	100.0%	100.0%	10.5%	(14.3)%
Cost of sales	48.4	51.6	48.2	3.6	(8.2)
Gross margin	51.6	48.4	51.8	17.8	(19.9)
Operating expenses:					
Sales and marketing	20.4	22.1	22.5	1.7	(15.6)
Research and development	9.3	10.9	11.0	(5.6)	(15.5)
General and administrative	8.7	11.7	7.9	(17.2)	27.0
Acquired in-process research and development	21.4				
Restructuring	0.6	6.3		(90.3)	
	60.4	51.0	41.4	30.8	5.6
Operating (loss) income	(8.8)	(2.6)	10.4	(271.4)	(121.5)
Other income, principally interest	1.0	0.1	0.2	1,082.2	(53.6)
AetherWorks Corporation net operating loss		(3.5)	(1.9)	(100.0)	59.1
AetherWorks Corporation gain (write-off)	0.7	(3.5)		(123.4)	
(Loss) income before income taxes	(7.1)	(9.5)	8.7	17.7	(193.4)
Provision for income taxes	5.3	0.1	3.9	10,534.1	(98.8)
Net (loss) income	(12.4)%	(9.5)%	4.8%	(43.5)%	(269.8)%

FACTORS THAT MAY AFFECT FUTURE RESULTS >>

Certain statements made herein, which are summarized below, are forward-looking statements that involve risks 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 as follows:

- - DIGI'S STRATEGY OF ENHANCING SEASONED BUSINESSES WHILE ACHIEVING SIGNIFICANT MARKET SHARE IN NEW HIGH-GROWTH MARKETS SUCH AS REMOTE ACCESS AND INTERNET TELEPHONY AND THE FISCAL 1999 FOCUS ON ACCELERATING BUSINESS GROWTH AND LAYING A FOUNDATION FOR CONSISTENT EARNINGS IMPROVEMENT SHOULD BE CHARACTERIZED AS FORWARD-LOOKING AND, AS SUCH, MAY INVOLVE RISKS AND UNCERTAINTIES.

- - THE EXPECTATION OF CONTINUED GROWTH IN DEMAND FOR AND SALES OF THE COMPANY'S REMOTE ACCESS, INTERNET TELEPHONY AND VOIP PRODUCTS, THE COMPANY'S ABILITY TO PROVIDE PRODUCTS THAT TAKE ADVANTAGE OF NEW MARKET OPPORTUNITIES AND THE COMPANY'S BELIEF THAT NEW PRODUCTS WILL BE PROFITABLE -- This expectation may be impacted by 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 ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT WILL REACH TECHNOLOGICAL FEASIBILITY AND LEAD TO NEW USB PRODUCTS IN 1999 AND NEW INTERNET PROTOCOL TELEPHONY PRODUCTS IN 2000 AND 2001 WHICH WILL BENEFIT THE COMPANY IN THE FUTURE AND THE COMPANY'S ESTIMATION OF THE COSTS ASSOCIATED WITH SUCH DEVELOPMENT -- This expectation may be impacted by unanticipated expenses or obstacles to development, general market conditions or changes in competitive conditions.

- - THE COMPANY'S ASSUMPTIONS REGARDING REVENUE GROWTH, COST OF SALES, COST SAVINGS AND THE WEIGHTED AVERAGE COST OF CAPITAL USED TO VALUE IN-PROCESS RESEARCH AND DEVELOPMENT ACQUIRED IN RECENT ACQUISITIONS -- These assumptions may be impacted by general market conditions, unanticipated changes in expenses or sales, delays in the development of new products, the useful lives of such products once developed, component shortages, and technological advances and other changes in competitive conditions that would affect the value of the acquired in-process research and development.

- - 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.

- - THE COMPANY'S BELIEF THAT EVALUATIONS AND MODIFICATIONS OF YEAR 2000 COMPLIANCE MATTERS, INCLUDING YEAR 2000 COMPLIANCE OF THIRD PARTY SUPPLIERS, WILL NOT HAVE A MATERIAL ADVERSE EFFECT ON THE COMPANY'S OPERATIONS OR FINANCIAL POSITION -- This belief may be impacted by presently unanticipated delays in assessment or remediation, unanticipated increases in costs or non-compliance by third parties.

- - THE COMPANY'S EXPECTATION THAT VARIOUS RESTRUCTURING ACTIVITIES IN CONNECTION WITH THE ACQUISITION OF ITK INTERNATIONAL, INC. AND CENTRAL DATA CORPORATION WILL BE COMPLETED ACCORDING TO SCHEDULE -- This expectation may be impacted by presently unanticipated delays or expenses.

NET SALES >>

The $17.3 million increase in net sales from 1997 to 1998 and the $27.6 million decrease in net sales from 1996 to 1997 occurred within the Company's principal product groups as follows:

PRINCIPAL MARKET	PERCENT OF ANNUAL NET SALES			ANNUAL SALES INCREASE (DECREASE)	
	1998	1997	1996	1998	1997
Server Based	79.9%	75.7%	80.2%	16.6%	(19.1%)
Physical Layer	20.1%	23.9%	18.9%	(6.9%)	8.2%
Other	0%	.4%	.9%	(100%)	(56.5%)

Net sales in fiscal 1998 increased from fiscal 1997 largely because the Company reduced inventory levels in the North American distribution channel throughout 1997 and into the first quarter of fiscal 1998. This resulted in a net increase in sales within the distribution channel during the remainder of 1998. In addition, during the third and fourth quarters of fiscal 1998, the Company gave extended credit terms to North American distributors which provided incentive for them to increase their purchases. Such incented increases in sales to these customers could result in a decrease in sales to these customers in fiscal year 1999. The Company's fiscal 1998 net sales also increased due to the addition of $9.7 million in fourth-quarter sales made by newly acquired ITK International, Inc. (ITK) and Central Data Corporation (CDC). Net sales in 1997 declined from 1996 primarily due to the Company's inventory reductions in the North American distribution channel.

Net sales to original equipment manufacturers (OEMs), as a percentage of total net sales, declined to 22.2% versus 23.5% in 1997. The decrease was

principally a function of higher net sales to the distribution market. Net sales to OEMs for 1996 were 20.3% of total sales.

Net sales to the distribution markets, as a percentage of total net sales, increased to 69.3% in 1998, compared to 64.1% in 1997. This increase was a result of the Company's 1997 inventory reductions in the North American distribution channel, as previously discussed. Net sales to the distribution market for 1996 represented 65.5% of total net sales.

During fiscal years 1998, 1997 and 1996, the Company's net sales to customers outside the United States, primarily in Europe, were approximately $38.5 million, $39.6 million and $39.9 million, respectively, comprising approximately 21.1%, 23.9% and 20.0% of total net sales.

GROSS MARGIN >>

Gross margin in 1998 rose to 51.6%, compared to 48.4% in 1997. The increase was due to more stringent cost control and favorable product mix. Gross margin also benefited as net sales of historically lower-margin products -- largely OEM and certain physical layer products -- declined as a percentage of total net sales. Offsetting the favorable sales mix were increases in inventory valuation reserves, sales discounts granted, and a higher proportion of lower margin products sold in the fourth quarter of fiscal 1998 due to the acquisition of CDC and ITK. Gross margins on total ITK and CDC sales in the fourth quarter of fiscal 1998 were 44.0%. Gross margin in 1996 was 51.8%. The 1997 gross margin decline was principally due to the increase of OEM and physical layer product net sales as a percentage of total net sales as sales to the distribution markets were intentionally reduced in 1997. The Company increased its reserves for excess and obsolete inventories approximately $2.6 million in 1998. In 1997, these reserves increased approximately $1.5 million from the 1996 level.

OPERATING EXPENSES >>

Operating expenses in 1998 declined 5.0% from 1997, excluding acquired in-process research and development charges of $39,200,000 recorded in 1998 and the restructuring charges recorded in 1998 and 1997 of $1,020,000 and $10,471,482, respectively. The operating expense decline reflected reductions in the workforce, decreased marketing costs and cost savings achieved through the consolidation of U.S. research and development efforts, offset by CDC and ITK operating expenses of $3.8 million. General and administrative expenses declined in 1998 due to workforce reductions and cost-saving initiatives. Operating expenses in 1997 declined 7.5% from 1996, excluding restructuring charges. The decline resulted from cost-saving measures similar to those executed in 1998. General and administrative expenses increased 27.0% in 1997 from 1996 due to an increase in the provision for losses on accounts receivable, cost of management information systems and increased facilities expenditures.

The $1,020,000 restructuring charge recorded in the fiscal 1998 fourth quarter was associated with a board-approved plan to consolidate existing offices in Germany with those acquired from ITK. The charge consists principally of rent, contractual payments on office equipment, write-offs of leasehold improvements and severance costs associated with the elimination of six positions. These activities are expected to be completed in the second quarter of fiscal 1999. No portion of this liability has been paid as of September 30, 1998.

The $10,471,482 restructuring charge recorded in the fiscal 1997 second quarter was related to a board-approved plan to consolidate operations and reduce costs and expenses. The restructuring charge consisted of $1,259,769 in net cash expenditures (primarily severance), all of which had been paid as of September 30, 1997, and $9,211,713 resulting from the write-down of asset carrying values.

ACQUIRED IN-PROCESS
RESEARCH AND DEVELOPMENT >>

ACQUISITION OF ITK INTERNATIONAL, INC.:

In July 1998, the Company acquired all of the outstanding common stock of ITK. The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed, including estimated restructuring and integration costs of $3,484,000.

Components of the purchase consideration, including related transaction costs, consist of $14,767,154 in cash, the Company's common stock with a market value of $11,671,229 and $1,276,436 of replacement stock options issued by the Company to ITK option holders. The cash and the Company's common stock were issued in exchange for outstanding shares of ITK's common stock and the Company's stock options were issued in exchange for the outstanding ITK common stock options. The value of the Company's common stock issued was based on a per share value of approximately $20.25, which was the market value of the Company's common stock on the date the Company and ITK agreed to the terms of the purchase. The value of the Company's common stock options is based on the excess of the market value of the Company's common stock over the option exercise prices on the date that these options were granted to ITK employees. The purchase price will increase by $963,323 if the unvested portion of stock options granted to the ITK employees vest. Such amount has been recorded as unearned stock compensation.

Valuation of the intangible assets acquired was determined by an independent appraisal company and consists of purchased in-process research and development (IPR&D), proven technology and an assembled workforce. The purchase price exceeded the estimated fair value of tangible and intangible assets acquired by $7,130,253, which was recorded as goodwill.

The table below is an analysis of the purchase price allocation.

Cash and fair value of Company's common stock and common stock options issued	$ 26,276,436
Direct acquisition costs	1,438,383
ITK liabilities assumed, including estimated restructuring and integration costs of $3,484,000	39,784,248
Total purchase price	67,499,067
Estimated fair value of tangible assets acquired	21,668,814
Estimated fair value of:	
IPR&D	26,000,000
Identifiable intangible assets	12,700,000
Goodwill	7,130,253
	$ 67,499,067

Management, based upon an independent appraisal, estimates that $26,000,000 of the purchase price represents the fair value of purchased IPR&D that had not yet reached technological feasibility and has no alternative future use. The amount allocated to IPR&D was expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition.

The Company is using the acquired in-process research and development to create new products in the area of Internet Protocol telephony, which will become part of the Company's product line over the next several years. The Company anticipates the initial Internet Protocol telephony products developed from acquired in-process research and development will be released in 2000 and 2001. The Company expects that the acquired in-process research and development will reach technological feasibility, but there can be no assurance that the commercial viability of these products will be achieved.

The nature of the efforts required to develop the acquired in-process research and development into commercially viable products principally relates to the completion of all planning, designing, prototyping, verification and testing activities that are necessary to establish that the product can be produced to meet its design specifications, including functions, features and technical performance requirements. The estimated costs to be incurred to develop the purchased in-process technology into commercially viable products are approximately $24,800,000 in the aggregate through the year 2007, consisting of $300,000 in 1998; $2,000,000 in 1999; $4,800,000 in 2000; $4,800,000 in 2001; $4,300,000 in 2002; $3,200,000 in 2003; $2,500,000 in 2004; $1,400,000 in 2005; $900,000 in 2006 and $600,000 in 2007.

The value assigned to purchased in-process research and development was determined through independent appraisers, who projected cash flows related to future products expected to be derived once technological feasibility is achieved, including costs to complete the development of the technology and the future revenues and costs which are expected to result from commercialization of the products. These cash flows were discounted back to their present values. The resulting net cash flows from such projects are based on estimates made by the Company's management of revenues, cost of sales, research and development costs, selling, general and administrative costs, and income taxes resulting from such projects. These estimates are based on the following assumptions:

- The estimated revenues are based upon projected average annual revenue growth rates from future products expected to be derived once technological feasibility is achieved of between 18% and 65% during the period from 2000 through 2005. Estimated total revenues expected from products to be developed using purchased in-process research and development peak in the year 2005 and decline rapidly in 2006 and 2007 as other new products are expected to enter the market. These projections are based on estimates made by the Company's management of market size and growth (which are supported by independent market data), expected trends in technology and the nature and expected timing of new product introductions by ITK and its competitors. These estimates also include growth related to the Company utilizing certain ITK technologies under development in conjunction with the Company's products, the Company marketing and distributing the resulting products through the Company's resellers, and the Company enhancing the market's response to ITK's products by providing incremental financial support and stability.

- The estimated cost of sales as a percentage of revenues is expected to be lower than ITK's cost of sales would have been on a stand-alone basis primarily due to the Company's expected ability to achieve more favorable pricing from key component vendors and production efficiencies due to economies of scale achieved through combined operations.

- The estimated selling, general and administrative costs are expected to more closely approximate the Company's cost structure (approximately 34% of revenues in 1997), which is lower than ITK's cost structure (approximately 81% of revenues in fiscal 1997). Cost savings are expected to result primarily from: (a) the changes related to certain restructuring actions including the shut-down of certain existing ITK facilities and a reduction in certain administrative ITK employees; (b) the distribution of ITK's products through the Company's resellers (i.e., sales of higher volume products with

lower direct selling costs); and (c) efficiencies due to economies of scale through combined operations (i.e., consolidated marketing and advertising programs). These cost savings are expected to be realized primarily in 2000 and thereafter.

- - Discounting the net cash flows back to their present values is based on the weighted averages cost of capital (WACC). The WACC calculation produces the average required rate of return of an investment in an operating enterprise, based on various required rates of return from investments in various areas of that enterprise. The WACC assumed for the Company, as a corporate business enterprise, is 14%. The discount rate used in discounting the net

cash flows from purchased in-process technology was 30%. This discount rate is higher than the WACC due to the inherent uncertainties in the estimates described above including the uncertainty surrounding the successful development of the purchased in-process research and development, the useful life of such completed research and development, the profitability levels of such completed research and development and the uncertainty of technological advances that are unknown at this time. If these products are not successfully developed, the sales and profitability of the combined company may be adversely affected in future periods. Additionally, the value of other intangible assets acquired may become impaired. The Company expects to begin to benefit from the purchased in-process research and development in 2000.

The identifiable intangible assets of $12,700,000 included in the purchase price allocation set forth above are comprised of proven technology with an appraised fair value of $11,300,000 and an assembled workforce with an appraised fair value of $1,400,000, which have estimated useful lives of five years and six years, respectively. The remaining unallocated purchase price represents goodwill which is being amortized over seven years.

ACQUISITION OF CENTRAL DATA CORPORATION:

In July 1998, the Company acquired all of the outstanding common stock of CDC. The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed, including estimated restructuring and integration costs of $750,000.

Components of the purchase consideration, including related transaction costs, consist of $14,261,965 in cash, the Company's common stock with a market value of $4,039,475 and $891,184 of replacement stock options issued by the Company to CDC option holders. The cash and the Company's common stock were issued in exchange for outstanding shares of CDC's common stock and the Company's stock options were issued in exchange for the outstanding CDC common stock options. The value of the Company's common stock issued was based on a per share value of approximately $20.25, which was the market value of the Company's common stock on the date the Company and CDC agreed to the terms of the purchase. The value of the Company's common stock options is based on the excess of the market value of the Company's common stock over the option exercise prices on the date that these options were granted to CDC employees. The purchase price will increase by $1,230,683 if the unvested portion of stock options granted to the CDC employees vest. Such amount has been recorded as unearned stock compensation.

Valuation of the intangible assets acquired was determined by an independent appraisal company and consists of purchased in-process research and development (IPR&D), proven technology and an assembled workforce. The purchase price exceeded the estimated fair value of tangible and intangible assets acquired by $1,034,833, which was recorded as goodwill.

The table below is an analysis of the purchase price allocation.

Cash and fair value of Company's common stock and common stock options issued	$ 18,891,184
Direct acquisition costs	301,440
CDC liabilities assumed, including estimated restructuring and integration costs of $750,000	4,394,617
Total purchase price	23,587,241
Estimated fair value of tangible assets acquired	5,252,408
Estimated fair value of:	
IPR&D	13,200,000
Identifiable intangible assets	4,100,000
Goodwill	1,034,833
	$ 23,587,241

Management, based upon an independent appraisal, estimates that $13,200,000 of the purchase price represents the fair value of purchased IPR&D that had not yet reached technological feasibility and has no alternative future use. The amount allocated to IPR&D was expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition. The Company is using the acquired in-process research and development to create new products based on the Universal Serial Bus, which is emerging as a new industry-standard serial communications bus architecture, and which will become part of the Company's product line over the next several years. The Company anticipates that Universal Serial Bus products developed from acquired in-process research and development will be released in 1999. The Company expects that the acquired in-process research and development will reach technological feasibility, but there can be no assurance that the commercial viability of these products will be achieved.

The nature of the efforts required to develop the acquired in-process research and development into commercially viable products principally relates to the completion of all planning, designing, prototyping, verification and testing activities that are necessary to establish that the product can be produced to meet its design specifications, including functions, features and

technical performance requirements. The estimated costs to be incurred to develop the purchased in-process technology into commercially viable products are approximately $5,000,000 in the aggregate through the year 2004, consisting of $200,000 incurred during the period from July 1998 through September 30, 1998, and $800,000 per year from 1999 to 2004.

The value assigned to purchased in-process research and development was determined by independent appraisers, who projected cash flows related to future products expected to be derived once technological feasibility is achieved, including costs to complete the development of the technology and the future revenues and costs which are expected to result from commercialization of the products. These cash flows were discounted back to their present

values. The resulting net cash flows from such projects are based on estimates made by the Company's management of revenues, cost of sales, research and development costs, selling, general and administrative costs, and income taxes resulting from such projects. These estimates are based on the following assumptions:

- - The estimated revenues are based upon projected average annual revenue growth rates from future products expected to be derived once technological feasibility is achieved of between 9% and 52% during the period from 2000 through 2002. Estimated total revenues expected from products to be developed using purchased in-process research and development peak in the year 2002 and decline rapidly in 2003 and 2004 as other new products are expected to enter the market. These projections are based on estimates made by the Company's management of market size and growth (which are supported by independent market data), expected trends in technology and the nature and expected timing of new product introductions by CDC and its competitors. These estimates also include growth related to the Company utilizing certain CDC technologies under development in conjunction with the Company's products, the Company marketing and distributing the resulting products through the Company's resellers, and the Company enhancing the market's response to CDC's products by providing incremental financial support and stability.

- - The estimated cost of sales as a percentage of revenues is expected to be lower than CDC's cost of sales would have been on a stand-alone basis primarily due to the Company's expected ability to achieve more favorable pricing from key component vendors and production efficiencies due to economies of scale achieved through combined operations.

- - The estimated selling, general and administrative costs are expected to remain at approximately the same levels for the Company and CDC (approximately 33% of revenues for both the Company and CDC in 1997).

- - Discounting the net cash flows back to their present values is based on the weighted average cost of capital (WACC). The WACC calculation produces the average required rate of return of an investment in an operating enterprise, based on various required rates of return from investments in various areas of that enterprise. The WACC assumed for the Company, as a corporate business enterprise, is 14%. The discount rate used in discounting the net cash flows from purchased in-process technology was 30%. This discount rate is higher than the WACC due to the inherent uncertainties in the estimates described above including the uncertainty surrounding the successful development of the purchased in-process research and development, the useful life of such completed research and development, the profitability levels of such completed research and development and the uncertainty of technological advances that are unknown at this time.

If these products are not successfully developed, the sales and profitability of the combined Company may be adversely affected in future periods. Additionally, the value of other intangible assets acquired may become impaired. The Company expects to begin to benefit from the purchased in-process research and development in 1999.

The identifiable intangible assets of $4,100,000 included in the purchase price allocation set forth above are comprised of proven technology with an appraised fair value of $3,700,000, and an assembled workforce with an appraised fair value of $400,000, which have estimated useful lives of five years and six years, respectively. The remaining unallocated purchase price represents goodwill, which is being amortized over seven years.

The Company has responded to questions provided by the staff of the Securities and Exchange Commission about the Company's write-offs of acquired in-process research and development in connection with the ITK and CDC acquisitions. As of December 11, 1998, the Company had not received any further comments from the Securities and Exchange Commission.

OTHER INCOME >>

Other income for 1998 increased approximately $3.0 million, as the Company earned higher interest income on its increased cash and cash equivalent balances. Other income also included a fiscal 1998 third-quarter reversal of a $1.4 million previously accrued obligation related to lease guarantees for AetherWorks Corporation. As discussed in the next item below, the obligation is no longer required because the Company is no longer the primary guarantor for these leases.

AETHERWORKS CORPORATION
NET LOSS AND WRITE-OFF >>

In connection with the Company's previously purchased $13.8 million of convertible notes from AetherWorks Corporation, in May 1998 the Company exchanged such notes for a non-interest bearing $8.0 million non-convertible note and was released from all of its guarantees of certain lease obligations of AetherWorks. Due to significant uncertainty as to its collectibility, the $8.0 million note, which matures in 2001, has been recorded by the Company as having no carrying value. In fiscal 1997 and 1996, the Company used the equity method to account for its investment in AetherWorks and recorded net losses of $5.8 million and $3.6 million, respectively. These net losses represent 100% of AetherWorks' losses for those years. The percentage of AetherWorks' net losses included in the Company's financial statements was based upon the percentage of financial support provided by the Company (versus other investors) during those years. The Company wrote off its investment in AetherWorks as of September 30, 1997, and recorded a $5.8 million charge, composed of its $2.4 million remaining

investment, its

$2.0 million remaining obligation to purchase additional notes and $1.4 million for the obligation to guarantee certain AetherWorks leases. The Company no longer has any funding obligations or any potential equity interest in or management control over AetherWorks. Consequently, the Company has not included any of AetherWorks' net losses in its results of operations during fiscal 1998.

INCOME TAXES >>

The Company recorded a $9.7 million tax provision for 1998, even though it has reported a pre-tax loss for the year. This tax provision was required primarily because the write-off of acquired in-process research and development and the amortization of certain intangible assets and goodwill acquired in the purchase of ITK and CDC is not deductible for income tax reporting purposes. In 1997, the Company recorded a $0.1 million tax provision, while reporting a pre-tax loss for that year. That provision was necessary due to the non-deductibility of certain intangible assets written off as part of the restructuring charge, the AetherWorks net losses and the related investment write-off. In addition, the Company had also provided additional provision in connection with an IRS examination of certain tax returns filed in prior years. In 1996, the Company recorded a $7.5 million income tax provision at a higher rate than the federal statutory rate due primarily to the nondeductability of the AetherWorks net losses.

INFLATION >>

The Company believes inflation has not had a material effect on its operations or 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 in 1998 consisted of the acquisitions of ITK and CDC for a combined purchase price of $46.9 million, including the issuance of $15.7 million of common stock, $2.2 million of replacement stock options, and cash payments of $29 million. In connection with the acquisitions, the Company also assumed $22.1 million in line of credit obligations and long-term debt in the fourth quarter of fiscal 1998, reflecting the outstanding debt of ITK and CDC.

Other investing activities in 1998 consisted primarily of purchases of $5.8 million of equipment and capital improvements, including a new enterprise-wide computer system. In addition, the final payments totaling $2 million for AetherWorks Corporation notes were made in 1998.

In September 1998, the Board of Directors authorized a program to repurchase up to one million shares of the Company's common stock for use in the Company's benefit plans. As of September 30, 1998, 15,000 shares had been repurchased under this program.

Investing activities in 1997 consisted of purchases of $8.8 million of equipment and capital improvements and the purchase of $6.5 million of additional convertible notes from AetherWorks Corporation.

At September 30, 1998, the Company had working capital of $37.9 million and debt totaling $22.1 million. The Company maintains lines of credit with various financial institutions providing for borrowings of up to $25,707,000, depending upon levels of eligible accounts receivable and inventories. As of September 30, 1998, $10,707,000 had been borrowed under these lines of credit. 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 future business operations.

FOREIGN CURRENCY TRANSLATION >>

Substantially all of the Company's foreign transactions are negotiated, invoiced and paid in U.S. dollars -- except for approximately $5.8 million in Deutschemark-denominated sales made through the Company's newly-acquired subsidiary, ITK. In future periods, a significant portion of sales made through ITK will be made in Deutschemarks until full integration of the "euro" is achieved. The Company has not implemented a hedging strategy to reduce the risk of foreign currency translation exposures, which management does not believe to be significant based on the scope of the Company's foreign operations as of September 30, 1998.

Effective January 1, 1999, eleven states of the European Union will convert to a common currency, called the "euro." This action will most likely cause the majority of the Company's European transactions to be negotiated, invoiced and paid in "euros." The conversion will most likely add currency exchange costs and risks, although such costs and risks are not quantifiable at this time.

YEAR 2000 ISSUES >>

The Company began a comprehensive project in 1996 to prepare its products and its internal computer systems for the year 2000. Most of the Company's products are year 2000 compliant because there is very little or no date processing involved. Certain products, including end-of-life versions, do require customer action such as a patch or version upgrade to be compliant.

These products are being identified, and the Company is in the process of notifying impacted customers.

The Company believes its implementation of a new enterprise-wide information management system, principally installed to improve operating efficiency, will address the Company's internal year 2000 compliance issues. Because of the acquisitions of ITK and CDC, the world-wide rollout of this system will not be completed until the late summer of calendar year 1999. If necessary conversions are not completed on a timely basis, the year 2000 could have

a material adverse effect on the Company's operations. Overall, management believes the year 2000 will not have a significant impact on operations.

The Company plans to continue with remediation and testing efforts with both its products and internal systems to further mitigate any risks associated with the year 2000. At this time, the Company believes it is unnecessary to adopt a contingency plan covering the possibility that the year 2000 project will not be completed in a timely manner, but, as part of the overall project, the Company will continue to assess the need for a contingency plan based on the Company's periodic evaluation of target dates for the completion of the year 2000 project.

The Company faces risk to the extent that suppliers of products and services purchased by the Company and others with whom the Company transacts business on a world-wide basis do not have business products and services that comply with year 2000 requirements. The Company has obtained assurances from most of its key suppliers that their products and services are year 2000 compliant. In the event any such third parties cannot, in a timely manner, provide the Company with products and services that meet the year 2000 requirements, the Company's operating results could be materially adversely affected.

The costs associated with the year 2000 project are minimal and are not incremental to the Company, but include temporary reallocation of existing resources. Although the Company believes that the remaining cost of year 2000 modifications for both internal-use systems and the Company's products are not material, there can be no assurances that various factors relating to the year 2000 compliance issues, including litigation, will not have a material adverse effect on the Company's business, operating results, or financial position.

NEW ACCOUNTING STANDARDS >>

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income." The statement establishes standards for the reporting and display of comprehensive income and its components. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. This standard will require that an enterprise display an amount representing total comprehensive income for the period. Statement No. 130 will be initially effective for the first quarter of the Company's fiscal year ending September 30, 1999. Adoption of Statement of Financial Accounting Standards No. 130 will not impact the results of operations or the financial position of the Company.

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information," which supersedes Statement No. 14. This statement changes the way that public business enterprises report segment information, including financial and descriptive information about their operating segments, in annual financial statements and would require that those enterprises report selected segment information in interim financial reports to stockholders. Operating segments are defined as revenue-producing components of the enterprise which are generally used internally for evaluating segment performance. Statement No. 131 will be effective for the Company beginning with the first quarter of the Company's fiscal year ending September 30, 1999. Management has not yet completed its analysis of the effects of Statement No. 131 on its financial reporting.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." Statement No. 133 will be effective for the Company beginning with the Company's fiscal year ending September 30, 2000. As the Company presently has no derivative instruments and is not involved in hedging activity, the Company does not expect the adoption of Statement No. 133 to have an impact on the results of operations or the financial position of the Company.

In October 1997, Statement of Position 97-2, "Software Revenue Recognition" (SOP 97-2), was issued. SOP 97-2 provides guidance on when revenue should be recognized and in what amounts for licensing, selling, leasing or otherwise marketing computer software. SOP 97-2 will become effective for the Company's fiscal year ending September 30, 1999. The adoption of SOP 97-2 is not expected to have a significant impact on the results of operations or financial position of the Company.

CONSOLIDATED STATEMENTS OF OPERATIONS >>

FOR THE FISCAL YEARS ENDED SEPTEMBER 30,	1998	1997	1996
Net sales	$ 182,931,670	$ 165,597,937	$ 193,150,898
Cost of sales	88,539,156	85,482,536	93,108,624
Gross margin	94,392,514	80,115,401	100,042,274
Operating expenses:			
Sales and marketing	37,288,027	36,671,271	43,449,864
Research and development	16,963,410	17,978,135	21,279,551
General and administrative	16,003,146	19,324,777	15,215,512
Acquired in-process research and development	39,200,000		
Restructuring	1,020,000	10,471,482	
Total operating expenses	110,474,583	84,445,665	79,944,927
Operating (loss) income	(16,082,069)	(4,330,264)	20,097,347
Other income, net	1,818,286	153,809	331,789
AetherWorks Corporation net operating loss		(5,764,201)	(3,623,776)
AetherWorks Corporation gain (write-off)	1,350,000	(5,758,548)	
(Loss) income before income taxes	(12,913,783)	(15,699,204)	16,805,360
Provision for income taxes	9,745,088	91,640	7,505,140
Net (loss) income	$ (22,658,871)	$ (15,790,844)	$ 9,300,220
Net (loss) income per common share, basic	$ (1.65)	$ (1.18)	$ 0.70
Net (loss) income per common share, assuming dilution	$ (1.65)	$ (1.18)	$ 0.68
Weighted average common shares, basic	13,729,765	13,393,408	13,323,564
Weighted average common shares, assuming dilution	13,729,765	13,393,408	13,583,468

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

CONSOLIDATED BALANCE SHEETS >>

AT SEPTEMBER 30,	1998	1997
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,355,368	$ 31,329,666
Accounts receivable, net	48,549,145	25,658,522
Inventories, net	27,365,924	23,683,312
Other	6,139,941	4,147,942
Total current assets	92,410,378	84,819,442
Property, equipment and improvements, net	33,990,923	23,617,696
Intangible assets, net	31,354,483	6,876,597
Other	2,978,883	2,997,601
Total assets	$ 160,734,667	$ 118,311,336
LIABILITES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Borrowings under line of credit agreements	$ 10,707,000	
Current portion of long-term debt	264,025	
Accounts payable	15,255,175	$ 10,118,921
Income taxes payable	3,797,588	1,771,986
Accrued expenses:		
Advertising	2,651,742	2,847,672
Compensation	6,776,292	2,388,468
AetherWorks Corporation funding obligation		3,350,000
Other	9,808,835	2,363,258
Restructuring reserves	5,254,000	
Total current liabilities	54,514,657	22,840,305
Long-term debt	11,124,446	
Other	275,000	
Total liabilities	65,914,103	22,840,305
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value: 2,000,000 shares authorized; none outstanding		
Common stock, $0.01 par value; 60,000,000 shares authorized; 15,790,975 and 14,727,256 shares issued	157,910	147,273
Additional paid-in capital	68,695,448	44,403,102
Retained earnings	52,455,031	75,113,902
Cumulative foreign currency translation adjustment	(815,809)	
	120,492,580	119,664,277
Unearned stock compensation	(3,777,204)	(1,787,658)
Treasury stock, at cost, 1,247,094 and 1,269,492 shares	(21,894,812)	(22,405,588)
Total stockholders' equity	94,820,564	95,471,031
Total liabilities and stockholders' equity	$ 160,734,667	$ 118,311,336

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

CONSOLIDATED STATEMENTS OF CASH FLOWS >>

FOR THE FISCAL YEARS ENDED SEPTEMBER 30,	1998	1997	1996
Operating activities:			
Net (loss) income	$ (22,658,871)	$(15,790,844)	$ 9,300,220
Adjustments to reconcile net (loss) income to cash provided by (used in) operating activities:			
Acquired in-process research and development	39,200,000		
Restructuring	1,020,000	9,211,713	
Depreciation of property and equipment	5,174,725	5,587,132	5,017,735
Amortization of intangibles	2,540,480	1,114,023	1,320,457
AetherWorks Corporation net loss		5,764,201	3,623,776
AetherWorks Corporation (gain) write-off	(1,350,000)	5,758,548	
Loss on sale of fixed assets	159,498	760,555	238,222
Provision for losses on accounts receivable	708,992	1,933,251	262,164
Provision for inventory obsolescence	3,414,270	2,910,988	1,455,895
Deferred income taxes	(790,544)	(1,787,933)	(393,153)
Stock compensation	1,012,440	244,569	204,973
Changes in operating assets and liabilities:			
Accounts receivable	(17,687,833)	15,283,125	(11,176,126)
Inventories	(569,839)	3,780,241	(7,808,974)
Income taxes payable (receivable)	883,900	3,447,612	(1,545,461)
Other assets	(3,226,694)	713,772	(1,953,252)
Accounts payable	279,238	(2,430,817)	443,223
Accrued expenses	2,279,156	153,448	(664,452)
Total adjustments	33,047,789	52,444,428	(10,974,973)
Net cash provided by (used in) operating activities	10,388,918	36,653,584	(1,674,753)
Investing activities:			
Purchase of property and equipment and certain other intangible assets	(5,816,163)	(8,841,473)	(12,902,436)
Proceeds from sale of fixed assets			1,133,197
Proceeds from held-to-maturity marketable securities			20,640,962
Proceeds from available-for-sale marketable securities			13,060,000
Purchase of held-to-maturity marketable securities			(482,187)
Purchase of available-for-sale marketable securities			(5,250,000)
Business acquisitions, net of cash acquired	(27,356,560)		
Investment in AetherWorks Corporation	(2,000,000)	(6,500,000)	(5,296,525)
Net cash (used in) provided by investing activities	(35,172,723)	(15,341,473)	10,903,011
Financing activities:			
Payments on long-term debt	(73,000)		
Proceeds from the issuance of long-term debt	2,064,865		
Purchase of treasury stock	(153,750)		(7,249,325)
Stock option transactions, net	2,310,572	539,838	1,659,838
Employee stock purchase plan transactions, net	471,629	534,327	200,888
Net cash provided by (used in) financing activities	4,620,316	1,074,165	(5,388,599)
Effect of exchange rates changes on cash and cash equivalents	(810,809)		
Net (decrease) increase in cash and cash equivalents	(20,974,298)	22,386,276	3,839,659
Cash and cash equivalents, beginning of period	$ 31,329,666	$ 8,943,390	$ 5,103,731
Cash and cash equivalents, end of period	$ 10,355,368	$ 31,329,666	$ 8,943,390
Supplemental Cash Flows Information:			
Interest paid	$ 224,730	$ 208,000	$ 224,730
Income taxes paid	$ 7,463,578	$ 238,439	$ 8,944,627

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY >>

FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 1998, 1997 AND 1996

	COMMON STOCK SHARES	COMMON STOCK PAR VALUE	TREASURY STOCK SHARES	TREASURY STOCK VALUE	ADDITIONAL PAID-IN-CAPITAL
Balances, September 30, 1995	14,562,958	$145,630	1,032,729	$(16,631,542)	$41,306,320
Purchase of treasury stock, at cost			315,000	(7,249,325)	
Employee stock purchase issuances			(8,835)	200,888	
Issuance of stock options at below market prices					12,500
Stock compensation					
Issuance of stock upon exercise of stock options	114,192	1,142			1,159,569
Tax benefit realized upon exercise of stock options					499,127
Forfeiture of stock options					(110,758)
Net income					
Balances, September 30, 1996	14,677,150	146,772	1,338,894	(23,679,979)	42,866,758
Employee Stock Purchase issuances			(69,402)	1,274,391	(740,064)
Issuance of stock options at below market prices					1,892,015
Stock compensation					
Issuance of stock upon exercise of stock options, net of withholding	50,106	501			379,720
Tax benefit realized upon exercise of stock options					159,617
Forfeiture of stock options					(154,944)
Net loss					
Balances, September 30, 1997	14,727,256	147,273	1,269,492	(22,405,588)	44,403,102
Issuance of stock for acquisitions	775,837	7,758			17,870,562
Purchase of treasury stock, at cost			15,000	(153,750)	
Employee Stock Purchase issuances			(37,398)	664,526	(192,897)
Issuance of stock options at below market prices					3,171,305
Stock compensation					
Issuance of stock upon exercise of stock options, net of withholding	287,882	2,879			2,307,694
Tax benefit realized upon exercise of stock options					1,305,001
Forfeiture of stock options					(169,319)
Foreign currency translation adjustment					
Net loss					
Balances, September 30, 1998	15,790,975	$157,910	1,247,094	$(21,894,812)	$68,695,448

	RETAINED EARNINGS	UNEARNED STOCK COMPENSATION	CUMULATIVE TRANSLATION	TOTAL STOCKHOLDERS' EQUITY
Balances, September 30, 1995	$81,604,526	$(598,387)		$105,826,547
Purchase of treasury stock, at cost				(7,249,325)
Employee stock purchase issuances				200,888
Issuance of stock options at below market prices		(12,500)		
Stock compensation		204,973		204,973
Issuance of stock upon exercise of stock options				1,160,711
Tax benefit realized upon exercise of stock options				499,127
Forfeiture of stock options		110,758		
Net income	9,300,220			9,300,220
Balances, September 30, 1996	90,904,746	(295,156)		109,943,141
Employee Stock Purchase issuances				534,327
Issuance of stock options at below market prices		(1,892,015)		
Stock compensation		244,569		244,569
Issuance of stock upon exercise of stock options, net of withholding				380,221
Tax benefit realized upon exercise of stock options				159,617
Forfeiture of stock options		154,944		
Net loss	(15,790,844)			(15,790,844)

Balances, September 30, 1997	75,113,902	(1,787,658)		95,471,031
Issuance of stock for acquisitions				17,878,320
Purchase of treasury stock, at cost				(153,750)
Employee Stock Purchase issuances				471,629
Issuance of stock options at below market prices		(3,171,305)		
Stock compensation		1,012,440		1,012,440
Issuance of stock upon exercise of stock options, net of withholding				2,310,573
Tax benefit realized upon exercise of stock options				1,305,001
Forfeiture of stock options		169,319		
Foreign currency translation adjustment			$(815,809)	(815,809)
Net loss	(22,658,871)			(22,658,871)
Balances, September 30, 1998	$52,455,031	$(3,777,204)	$(815,809)	$94,820,564

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 is a leading worldwide provider of data communications products for open systems, server-based remote access, Internet telephony, and local area network (LAN) applications. Digi's communications products support a broad range of server platforms and network operating systems that enable people to access information.

Digi's products are marketed through a global network of distributors, system integrators, original equipment manufacturers (OEMs), as well as thousands of value-added resellers (VARs).

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, while those having original maturities in excess of three months are classified as marketable securities and generally consist of U.S. Government and U.S. Government-backed obligations and high-grade commercial paper. Marketable securities classified as held to maturity are carried at amortized cost. Marketable securities classified as trading or available-for-sale are recorded at market value. The Company had no marketable securities as of September 30, 1998 or 1997.

REVENUE RECOGNITION

Sales are recognized to distributors, VARs, and end-users at the date of shipment. Estimated warranty costs and customer returns are recorded at the time of sale.

The Company offers rebates to authorized domestic and international distributors and authorized resellers. The rebates are incurred based on the level of sales to the respective distributors and resellers, and are charged to operations in the same period as the corresponding sales.

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.

The Company's cost of business process reengineering activities, whether done internally or by third parties, is expensed as incurred.

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 identifiable assets acquired and is being amortized on a straight-line basis over periods ranging from five to 15 years. All other intangible assets are amortized on a straight-line basis over their estimated useful lives of one to seven 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 capitalized 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

Net income (loss) per share has been calculated for all periods pursuant to the provisions of Statement of Financial Accounting Standards No. 128, which the Company adopted in the first quarter of fiscal 1998. Basic net income (loss) per share is calculated based on only the weighted average of common shares outstanding during

the period. Net income (loss) per share, assuming dilution, is computed by dividing net income (loss) by the weighted average number of common and common equivalent shares outstanding. The Company's only common stock equivalents are those that result from dilutive common stock options. The calculation of diluted earnings per common share for 1996 includes 259,904 of such common stock equivalents. The calculation of diluted loss per common share for 1998 and 1997 excludes 835,670 and 236,165 equivalent shares, respectively, of the Company's common stock attributable to common stock options because their effect would be antidilutive.

FOREIGN CURRENCY TRANSLATION

Financial position and results of operations of the Company's international subsidiaries generally are measured using local currencies as the functional currency. Assets and liabilities of these operations are translated at the exchange rates in effect at each fiscal year-end. Statements of operations accounts are translated at the average rates of exchange prevailing during the year. Translation adjustments arising from the use of differing exchange rates from period to period are included in the cumulative translation account in stockholders' equity.

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 estimated fair value and lives of acquired in-process research and development and other acquired intangible assets, allowances for obsolete inventories, uncollectable accounts receivable and sales returns and accruals for warranty costs.

NEW ACCOUNTING STANDARDS

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income." The statement establishes standards for the reporting and display of comprehensive income and its components. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. This standard will require that an enterprise display an amount representing total comprehensive income for the period. Statement No. 130 will be initially effective for the first quarter of the Company's fiscal year ending September 30, 1999. Adoption of Statement of Financial Accounting Standards No. 130 will not impact the results of operations or the financial position of the Company.

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information," which supersedes Statement No. 14. This statement changes the way that public business enterprises report segment information, including financial and descriptive information about their operating segments, in annual financial statements and would require that those enterprises report selected segment information in interim financial reports to stockholders. Operating segments are defined as revenue-producing components of the enterprise which are generally used internally for evaluating segment performance. Statement No. 131 will be effective for the Company beginning with the first quarter of the Company's fiscal year ending September 30, 1999. Management has not yet completed its analysis of the effects of this Statement on its financial reporting.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." Statement No. 133 will be effective for the Company beginning with the Company's fiscal year ending September 30, 2000. As the Company presently has no derivative instruments and is not involved in hedging activity, the Company does not expect the adoption of Statement No. 133 to have an impact on the results of operations or the financial position of the Company.

In October 1997, Statement of Position 97-2, "Software Revenue Recognition" (SOP 97-2), was issued. SOP 97-2 provides guidance on when revenue should be recognized and in what amounts for licensing, selling, leasing or otherwise marketing computer software. SOP 97-2 will become effective for the Company's fiscal year ending September 30, 1999. The adoption of SOP 97-2 is not expected to have a significant impact on the results of operations or financial position of the Company.

2 >> ACQUISITIONS

In July 1998, the Company acquired all of the outstanding common stock of ITK International, Inc. (ITK). The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed.

Components of the purchase consideration, including related transaction

costs, consist of $14,767,154 in cash, the Company's common stock with a market value of $11,671,229 and $1,276,436 of replacement stock options issued by the Company to ITK option holders. The cash and the Company's common stock were issued in exchange for outstanding shares of ITK's common stock and the Company's stock options were issued in exchange for the outstanding ITK common stock options. The value of the Company's common stock issued was based on a per share value of approximately $20.25, which was the market value of the Company's common

stock on the date the Company and ITK agreed to the terms of the purchase. The value of the Company's common stock options is based on the excess of the market value of the Company's common stock over the option exercise prices on the date that these options were granted to ITK employees. The purchase price will increase by $963,323 if the unvested portion of stock options granted to the ITK employees vest. Such amount has been recorded as unearned stock compensation.

Valuation of the intangible assets acquired was determined by an independent appraisal company and consists of purchased in-process research and development (IPR&D), proven technology and an assembled workforce. The purchase price exceeded the estimated fair value of tangible and intangible assets acquired by $7,130,253, which was recorded as goodwill.

The table below is an analysis of the purchase price allocation.

Cash and fair value of Company's common stock and common stock options issued	$ 26,276,436
Direct acquisition costs	1,438,383
ITK liabilities assumed, including estimated restructuring and integration costs of $3,484,000	39,784,248
Total purchase price	67,499,067
Estimated fair value of tangible assets acquired	21,668,814
Estimated fair value of:	
IPR&D	26,000,000
Identifiable intangible assets	12,700,000
Goodwill	7,130,253
	$67,499,067

Management, based upon an independent appraisal, estimates that $26,000,000 of the purchase price represents the fair value of purchased IPR&D that had not yet reached technological feasibility and has no alternative future use. The amount allocated to IPR&D was expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition. The Company is using the acquired in-process research and development in the area of Internet protocol telephony, which will become part of the Company's product line over the next several years.

The identifiable intangible assets of $12,700,000 included in the purchase price allocation set forth above are comprised of proven technology with an appraised fair value of $11,300,000 and an assembled workforce with an appraised fair value of $1,400,000, which have estimated useful lives of five years and six years, respectively. The remaining unallocated purchase price represents goodwill, which is being amortized over seven years.

In July 1998, the Company acquired all of the outstanding common stock of Central Data Corporation (CDC). The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed, including estimated restructuring and integration costs of $750,000.

Components of the purchase consideration, including related transaction costs, consist of $14,261,965 in cash, the Company's common stock with a market value of $4,039,475 and $891,184 of replacement stock options issued by the Company to CDC option holders. The cash and the Company's common stock were issued in exchange for outstanding shares of CDC's common stock and the Company's stock options were issued in exchange for the outstanding CDC common stock options. The value of the Company's common stock issued was based on a per share value of approximately $20.25, which was the market value of the Company's common stock on the date the Company and CDC agreed to the terms of the purchase. The value of the Company's common stock options is based on the excess of the market value of the Company's common stock over the option exercise prices on the date that these options were granted to CDC employees. The purchase price will increase by $1,230,683 if the unvested portion of stock options granted to the CDC employees vest. Such amount has been recorded as unearned stock compensation.

Valuation of the intangible assets acquired was determined by an independent appraisal company and consists of purchased in-process research and development (IPR&D), proven technology and an assembled workforce. The purchase price exceeded the estimated fair value of tangible and intangible assets acquired by $1,034,833, which was recorded as goodwill.

The table below is an analysis of the purchase price allocation.

Cash and fair value of Company's common stock and common stock options issued	$ 18,891,184
Direct acquisition costs	301,440
CDC liabilities assumed, including estimated restructuring and integration costs of $750,000	4,394,617
Total purchase price	23,587,241
Estimated fair value of tangible assets acquired	5,252,408
Estimated fair value of:	
IPR&D	13,200,000
Identifiable intangible assets	4,100,000
Goodwill	1,034,833
	$ 23,587,241

Management, based upon an independent appraisal, estimates that $13,200,000 of the purchase price represents the fair value of purchased IPR&D that had not yet reached technological feasibility and has no alternative future use. The amount allocated to IPR&D was expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition. The Company is using the acquired in-process research and development to create new products based on the Universal Serial Bus, which will become part of the Company's product line over the next several years.

The identifiable intangible assets of $4,100,000 included in the purchase price allocation set forth above are comprised of proven technology with an appraised fair value of $3,700,000, and an assembled workforce with an appraised fair value of $400,000,

which have estimated useful lives of five years and six years, respectively. The remaining unallocated purchase price represents goodwill, which is being amortized over seven years.

The following unaudited pro forma condensed consolidated results of operations have been prepared as if the acquisitions of ITK and CDC had occurred as of the beginning of fiscal 1998 and 1997:

YEARS	1998	1997
Net sales	$ 220,271,670	$ 194,605,937
Net loss	$ (42,794,201)	$ (76,316,007)
Net loss per share	$ (2.88)	$ (5.39)

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the acquisitions been in effect for the years presented, nor are they necessarily indicative of the results that will be obtained in the future.

3 >> RESTRUCTURING

In July 1998, the Company's Board of Directors approved a restructuring plan related to the consolidation of its offices in Germany and the United Kingdom. The restructuring plan relates to the elimination of existing facilities rendered redundant by the acquisition of ITK. The charge of $1,020,000 ($647,000 net of tax benefits or $0.04 per share), consisted primarily of existing commitments for rent, contractual payments on office equipment, write-offs of leasehold improvements and severance costs associated with eliminating six positions. Management of the Company expects that these restructuring activities will be completed by the end of the second quarter of fiscal year 1999.

In connection with the Company's acquisition of ITK, the Company has implemented a plan of reorganization and accordingly, has recognized a $3,484,000 restructuring liability which the Company has included as a component of total liabilities assumed in the acquisitions. The components of the restructuring liability are as follows:

Personnel costs	$ 1,844,000
Facilities closure costs	1,640,000
	$ 3,484,000

Management of the Company expects to complete these restructuring activities by the end of the third quarter of fiscal year 1999. No amounts of this liability have been paid as of September 30, 1998.

In connection with the Company's acquisition of CDC, the Company has implemented a plan of reorganization and accordingly, the Company has recognized a $750,000 restructuring liability which the Company has included as a component of total liabilities assumed in the acquisition. The components of the restructuring liability are as follows:

Personnel costs	$ 675,000
Facilities closure costs	75,000
	$ 750,000

Management of the Company expects to complete these restructuring activities by the end of the second quarter of fiscal year 1999. No amounts of this liability have been paid as of September 30, 1998.

In February 1997, the Company's Board of Directors approved a restructuring plan that 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 resulted in 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 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. These restructuring activities were completed in fiscal year 1997.

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

4 >> RECLASSIFICATION OF CERTAIN EXPENSES

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 the years September 30, 1997 and 1996. Such amounts were $2,647,207 in 1997 and, $2,707,024 in 1996. These reclassifications had no impact on previously reported operating income, or net income.

5 >> INVESTMENT IN AETHERWORKS CORPORATION

In May 1998, the Company exchanged its previously purchased $13,796,525 of convertible notes from AetherWorks Corporation, a development stage company engaged in the development of wireless and dial-up remote access technology, for a non-interest bearing $8,000,000 non-convertible note. As a part of the exchange, the Company relinquished its rights to any future technology or claims on any of AetherWorks' intellectual properties. In exchange, the Company has been released from all of its guarantees of certain lease obligations of AetherWorks. As a result, the Company has

reversed its $1,350,000 accrual established in the fourth quarter of 1997, for the estimated cost related to its guarantee of such lease obligations and has included such amount in AetherWorks Corporation gain for the year ended September 30, 1998.

Due to the significant uncertainty as to its collectibility, the $8,000,000 note, which matures in 2001, has been recorded by the Company as having no carrying value.

The Company continues to lease to AetherWorks $1,325,000 of computer equipment under a three-year direct financing lease, expiring in 2000.

For the years 1997 and 1996, the Company has reported its investment in AetherWorks on the equity method and reported net losses of $5,764,201 and $3,623,776, respectively. These losses, which exclude $5,758,548 of additional charges accrued as of September 30, 1997 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.

Because of the significant uncertainty of the future of AetherWorks Corporation, as demonstrated by its lack of ability to generate positive cash flow, obtain 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 $2,408,548 in AetherWorks, and to accrue and expense its remaining obligation to purchase $2,000,000 of additional notes. In addition, the Company also accrued $1,350,000 for its obligation resulting from its guarantees of certain AetherWorks' lease obligations as of September 30, 1997.

The following represents condensed financial information from the audited statements of AetherWorks for the years ended September 30, 1997 and 1996:

AETHERWORKS CORPORATION

BALANCE SHEET DATA, AS OF SEPTEMBER 30,	1997	1996
Current assets	$ 955,695	$ 104,307
Fixed assets	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 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)

The "eliminations line" item represents interest expense payable to the Company for interest due on the notes issued by AetherWorks to the Company. This amount is excluded from the AetherWorks loss as the Company has eliminated the corresponding interest income from its Consolidated Statements of Operations.

6 >> SELECTED BALANCE SHEET DATA

	1998	1997
Accounts receivable, net:		
Trade accounts receivable	$ 53,618,657	$ 28,225,088
Less reserve for returns and doubtful accounts	5,069,512	2,566,566
	$ 48,549,145	$ 25,658,522
Inventories, net:		
Raw materials	$ 16,814,657	$ 10,160,377
Work in process	2,922,442	8,704,357
Finished goods	10,735,483	7,011,357
	30,472,582	25,876,091
Less reserve for obsolescence	3,106,658	2,192,779

	$ 27,365,924	$ 23,683,313
Property, equipment and improvements:		
Land	$ 2,774,300	$ 1,800,000
Buildings	19,912,614	10,522,285
Improvements	554,932	629,240
Equipment	20,859,857	18,377,899
Purchased software	6,968,127	5,186,787
Furniture and fixtures	929,889	927,859
	51,999,720	37,444,070
Less accumulated depreciation	18,008,797	13,826,374
	$ 33,990,923	$ 23,617,696
Intangible assets:		
Purchased technology	$ 15,910,858	$ 910,859
License agreements	3,476,400	1,133,900
Assembled workforce	1,800,000	
Other	1,483,836	1,772,035
Goodwill	14,529,328	6,364,242
	37,200,422	10,181,036
Less accumulated amortization	5,845,939	3,304,439
	$ 31,354,483	$ 6,876,597

7 >> BORROWING UNDER LINE OF CREDIT AGREEMENTS

The Company maintains lines of credit with various financial institutions which provide for borrowings of up to $25,707,000. As of September 30, 1998, $10,707,000 has been borrowed under these line of credit agreements. These line of credit agreements are uncollateralized and provide for interest rates ranging from 4.5% to 10.6% as of September 30, 1998.

8 >> LONG-TERM DEBT

Long-term debt consists of the following at September 30, 1998

5.5% fixed rate long-term collateralized note	$ 1,854,490
5.2% fixed rate long-term collateralized note	1,256,240
6.0% fixed rate long-term collateralized note	538,450
6.3% fixed rate long-term collateralized note	4,784,959
Variable rate long-term collateralized note	250,000
Long-term collateralized mortgage note	623,471
6.0% fixed rate long-term uncollateralized note	1,555,010
6.0% to 10.6% subsidized long-term notes	525,851
	$ 11,388,471
Less current portion	264,025
	$ 11,124,446

The 5.5% fixed rate long-term note is payable in semi-annual installments beginning September 2000. The 5.2% fixed rate long-term note is payable in semi-annual installments beginning June 2001. The 6.0% fixed rate long-term note is due in full on September 30, 2003. The 6.3% fixed rate long-term note is payable in semi-annual installments beginning March 2000. These notes are collateralized by land, buildings and equipment with a book value of $10,576,458. Interest on the notes is payable on a quarterly basis.

The variable rate long-term collateralized note is payable in quarterly principal payments and monthly interest payments. The interest rate is the bank's lending rate plus 0.75%. This rate as of September 30, 1998 was 9.25%. The note is collateralized by accounts receivable, inventory and property and equipment with a book value of $4,713,573.

The Long-term mortgage note bears interest at a fixed rate of 8.85% through February 2003 and then at prime plus 2.5%. The rate of interest is subject to adjustment every five years with a maximum rate of 12.5% for years 10-15 and 14.5% for years 15-20. The note and interest is payable in monthly installments. The note is collateralized by a building and certain equipment of the Company.

The 6.0% fixed rate long-term uncollateralized note is due in full in November 2001. Interest is payable annually.

The subsidized long-term notes bear interest rates ranging from 6% to 10.6% and are due at various dates through 2006. All borrowings under these notes are uncollateralized.

Aggregate maturities of long-term debt are as follows:

FISCAL YEAR	
1999	$ 264,025
2000	436,291
2001	462,562
2002	2,048,046
2003	1,131,762
Thereafter	7,045,785
	$ 11,388,471

9 >> INCOME TAXES

The components of the provision for income taxes for the years ended September 30, 1998, 1997, and 1996 are as follows:

	1998	1997	1996
Currently payable:			
Federal	$ 9,768,928	$ 1,737,116	$ 6,977,337
State	766,704	142,457	920,956
Deferred	(790,544)	(1,787,933)	(393,153)

	$ 9,745,088	$ 91,640	$ 7,505,140

The net deferred tax asset as of September 30, 1998 and 1997 consists of the following:

	1998	1997
Valuation reserves	$ 2,673,443	$ 1,740,540
Inventory valuation	430,501	800,364
Compensation costs	1,007,367	248,470
Depreciation	102,133	193,525
Net deferred tax asset	$ 4,213,444	$ 2,982,899

The reconciliation of the statutory federal income tax rate with the effective income tax rate for the years ended September 30, 1998, 1997, and 1996 is as follows:

	1998	1997	1996
Statutory income tax rate	(35.0)%	(34.0)%	35.0%
Increase (reduction) resulting from:			
Utilization of research and development tax credits		(0.9)	(1.7)
Utilization of low income housing credits	2.8	1.7	
State taxes, net of federal benefits	3.9		3.6
AetherWorks Corporation net operating loss		12.5	8.0
AetherWorks Corporation write-off		9.6	
Acquired in-process research and development	106.3		
Restructuring charges		9.3	
Tax contingencies		4.7	
Foreign and other	(2.5)	(2.8)	(0.2)
	75.5%	0.1%	44.7%

10 >> STOCK OPTIONS AND EMPLOYEE STOCK PURCHASE PLAN

The Company's stock option plan (the Stock Option Plan) provides for the issuance of nonstatutory stock options and incentive stock options (ISOs) to key employees and nonemployee board members holding less than 5% of the outstanding shares of the Company's common stock. The Company's Non-Officer Stock Option Plan (the Non-Officer Plan and, together with the Stock Option Plan, the Plans), provides for the issuance of nonstatutory stock options to key employees who are not officers or directors of the Company.

The option price for ISOs and non-employee directors options granted under the Stock Option Plan is set at the fair market value of the Company's common stock on the date of grant. The option price for nonstatutory options granted under the Plans is set by the Compensation Committee of the Board of Directors. The authority to grant options under the Plans and set other terms and conditions rests with the Compensation Committee. The Stock Option Plan terminates in 2006. The Non-Officer Plan does not have a designated termination date.

During the years ended September 30, 1998, 1997, and 1996, 287,882, 50,106, and 114,192 shares of the Company's Common Stock, respectively, were issued upon the exercise of options for 289,353, 50,167, and 123,959 shares, respectively. The difference between shares issued and options exercised results from the provision in the Plans 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 $28,871 in 1998, $5,171 in 1997, and $186,927 in 1996.

During the year ended September 30, 1998 the Board of Directors authorized the issuance of incentive stock options for the purchase of 486,631 shares. In addition, the Board of Directors authorized the issuance of nonstatutory stock options for the purchase of 543,461 shares, at prices below the market value of the stock on the grant dates.

During the year ended September 30, 1997 the Board of Directors authorized the cancellation and reissue of nonstatutory 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 year ended September 30, 1996, the Board of Directors authorized the issuance of nonstatutory stock options for the purchase of 2,500 shares at prices below the market value of the stock on the grant date.

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 contractual vesting period in which employees perform services and amounted to $1,012,440 in 1998, $244,569 in 1997, and $204,793 in 1996.

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

STOCK OPTIONS

	AVAILABLE FOR GRANT	OPTIONS OUTSTANDING	WEIGHTED AVERAGE PRICE PER SHARE
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	500,000		
Granted	(1,509,701)	1,509,701	8.62
Exercised		(50,617)	7.71
Cancelled	1,879,636	(1,879,636)	19.01
BALANCES, SEPTEMBER 30, 1997	1,224,449	1,916,108	$ 10.01
Additional shares approved for grant	750,000		
Granted	(1,254,525)	1,254,525	$ 15.96
Exercised		(289,353)	8.56
Cancelled	150,013	(150,013)	12.79
BALANCES, SEPTEMBER 30, 1998	869,937	2,731,267	$ 12.75

Commencing April 1996, the Company has sponsored an Employee Stock Purchase Plan (the Purchase Plan) which covers all domestic employees with at least 90 days of service. The Purchase 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 $658,118 in 1998, $534,327 in 1997, and $200,888 in 1996. Pursuant to the Purchase Plan, 37,398, 69,402, and 8,835 shares were issued to employees during the fiscal years ended 1998, 1997 and 1996, respectively. As of September 30, 1998, 384,365 shares are available for future issuances under the Purchase Plan.

11 >> STOCK-BASED COMPENSATION

In accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), the Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, compensation costs for stock options granted to employees are measured as the excess, if any, of the fair value of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock. Such compensation costs, if any, are amortized on a straight-line basis over the option vesting schedule.

Had the Company used the fair-value-based method of accounting for its stock options granted in 1998, 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 changed to the following pro forma amounts:

	1998	1997	1996
Net (loss) income			
As reported	$(22,658,871)	$ (15,790,844)	$9,300,220
Pro forma	(25,832,432)	(17,449,611)	8,536,111
Net (loss) income per share - basic			
As reported	$ (1.65)	$ (1.18)	$ 0.70
Pro forma	(1.88)	(1.30)	0.64
Net (loss) income per share - assuming dilution			
As reported	$ (1.65)	$ (1.18)	$ 0.68
Per forma	$ (1.88)	$ (1.30)	$ 0.63

The weighted average fair value of options granted in fiscal years 1998, 1997 and 1996 was $12.29, $12.47 and $10.14, 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:

ASSUMPTIONS:	1998	1997	1996
Risk free interest rate	5.49%	6.02%	5.99%
Expected option holding period	4 years	4 years	4 years
Expected volatility	60%	40%	50%
Expected dividend yield	0	0	0

At September 30, 1998, the weighted average exercise price and remaining life of the stock options are as follows:

RANGE OF EXERCISE PRICES	$0.50	$2.36-3.19	$3.78-3.92	$5.91-8.88	$9.40-14.00	$14.50-21.50	$22.00-29.25	TOTAL
Total options outstanding	3,000	146,451	32,418	1,166,807	295,751	770,965	315,875	2,731,267
Weighted average remaining contractual life (years)	0.67	7.70	1.91	8.00	7.78	8.75	8.20	8.11
Weighted average exercise price	$ 0.50	$ 2.53	$ 3.83	$ 7.73	$11.57	$17.98	$25.44	$ 12.75
Options exercisable	3,000	112,498	27,127	513,849	115,784	108,338	82,625	963,221
Weighted average exercise price of exercisable options	$ 0.50	$ 2.58	$ 3.84	$ 7.58	$ 11.87	$ 18.04	$ 24.17	$ 9.98

12 >> SHARE RIGHTS PLAN

The Company has adopted a share rights plan. Under the plan, the Company will distribute as a dividend one right for each share of the Company's common stock outstanding on June 30, 1998. Each right will entitle its holder to buy one one-hundreth of a share of a new series of junior participating preferred stock at an exercise price of $115, subject to adjustment. The rights will be exercisable only if certain ownership considerations are met. The Company will be entitled to redeem the rights prior to the rights becoming exercisable.

13 >> COMMITMENTS

The Company has entered into various operating lease agreements, the last of which expires in fiscal 2013. Below is a schedule of future minimum commitments under noncancellable operating leases:

FISCAL YEAR	AMOUNT
1999	$ 1,341,848
2000	1,143,148
2001	826,430
2002	385,510
2003	74,000
Thereafter	836,000

Total rental expense for all operating leases for the years ended September 30, 1998, 1997 and 1996 was $1,786,715, $1,405,582 and $965,710, respectively.

14 >> 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 pre-tax earnings, not to exceed amounts allowed under the Code. In addition, the Company may make contributions to the plan at the discretion

of the Board of Directors. The Company accrued $240,000 as a matching contribution for 1998. No Company contribution was made in 1997 or 1996.

15 >> FOREIGN SALES AND MAJOR CUSTOMERS

Foreign export sales, primarily to Europe, comprised 21.1%, 23.9%, and 20.0% of net sales for the years ended September 30, 1998, 1997 and 1996, respectively.

During 1998, one customer accounted for 15.5% of net sales and 26% of the trade accounts receivable as of September 30, 1998, while another accounted for 13.7% of net sales and 10% of the trade accounts receivable as of September 30, 1998.

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

During 1996, one customer accounted for 13.9% of net sales and 11.8% of accounts receivable as of September 30, 1996, while another accounted for 13.4% of net sales and 14.3% of accounts receivable as of September 30, 1996.

16 >> GEOGRAPHIC SEGMENTS

Summary information regarding the Company's operations in the United States and international markets is presented below. International consists primarily of European operations.

	1998	1997	1996
NET SALES			
United States	$171,385,998	$160,181,397	$188,897,751
International	11,545,672	5,416,540	4,253,147
Total	$182,931,670	$165,597,937	$193,150,898
OPERATING INCOME (LOSS)			
United States	$ 24,519,769	$ 6,037,670	$ 19,682,936
International	(381,838)	103,548	414,411
Total (1)	$ 24,137,931	$ 6,141,218	$ 20,097,347
IDENTIFIABLE ASSETS			
United States	$138,552,610	$116,100,151	$128,820,114
International	22,182,057	2,211,185	1,118,715
Total	$160,734,667	$118,311,336	$129,938,829

(1) EXCLUDES ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT CHARGE OF $39,200,000 FOR THE YEAR ENDED SEPTEMBER 30, 1998 AND ALSO EXCLUDES $1,020,000 AND $10,471,482 OF RESTRUCTURING CHARGES FOR THE YEARS ENDED SEPTEMBER 30, 1998 AND 1997, RESPECTIVELY.

17 >> FOURTH QUARTER INFORMATION

A provision for inventory obsolescence of $1.9 million was recorded during the three-month period ended June 30, 1998. This provision was reversed during the three-month period ended September 30, 1998.

18 >> 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, through a Consolidated Amended Complaint 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 Amended 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 Amended Complaint also alleges misrepresentations in violation of state common law.

In a decision issued on May 22, 1998, the District Court granted in part and denied in part the motions of the Company and its three former officers to dismiss the Consolidated Amended Complaint and the Louisiana Amended Complaint. The Court dismissed without leave to replead all claims asserted in both cases, except for certain federal securities law claims based upon alleged misrepresentations and/or omissions relating to the accounting treatment applied to the Company's AetherWorks investment. The Court also limited the claims asserted in the Louisiana Amended Complaint to the 11,000 shares of the Company's stock held subsequent to November 14, 1996. These claims remain pending against the Company and two of its former officers, Ervin F. Kamm, Jr. and Gerald A. Wall. Discovery in the actions is proceeding.

Because the lawsuits are in 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.

In the normal course of business, the Company is subject to various claims and litigation. Management of the Company expects that these various litigation items will not have a material adverse effect on the results of operations or financial condition of the Company.

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 ?nancial 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 PricewaterhouseCoopers LLP, independent certified public accountants. Their audit was 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/ William C. Nolte

William C. Nolte
Director of Finance and Controller

REPORT OF INDEPENDENT ACCOUNTANTS >>

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, cash flows and stockholders' equity present fairly, in all material respects, the financial position of Digi International Inc. and subsidiaries (the Company), at September 30, 1998 and 1997 and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles. 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 of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above. 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.

PricewaterhouseCoopers LLP
Minneapolis, Minnesota
December 11, 1998

QUARTERLY FINANCIAL DATA (UNAUDITED) >>

IN THOUSANDS EXCEPT PER SHARE AMOUNTS	QUARTER ENDED DEC. 31	MAR. 31	JUNE 30	SEPT. 30
1998				
Net sales	$ 42,590	$ 45,059	$ 46,449	$ 48,833
Gross margin	21,369	23,066	24,559(a)	25,399(a)
Acquired in-process research and development				39,200
Restructuring				1,020
AetherWorks Corporation gain			1,350	
Net income (loss)	3,842	4,665	6,411	(37,577)
Net income (loss) per share - basic	0.28	0.35	0.47	(2.62)
Net income (loss) per share - assuming dilution	0.27	0.33	0.45	(2.62)
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	(2,431)
Net (loss) income per share - basic	(0.19)	(0.70)	0.01	(0.29)
Net (loss) income per share - assuming dilution	(0.19)	(0.70)	0.01	(0.29)
1996				
Net sales	$ 43,716	$ 47,973	$ 49,643	$ 51,819
Gross margin	23,729	25,391	24,451	26,471
AetherWorks Corporation net loss	(279)	(656)	(1,204)	(1,485)
Net income (loss)	4,522	4,620	(51)	209
Net income per share - basic	0.34	0.35	0.00	0.02
Net income per share - assuming dilution	0.33	0.34	0.00	0.02

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) A PROVISION FOR INVENTORY OBSOLESCENCE OF $1.9 MILLION WAS RECORDED DURING THE THREE-MONTH PERIOD ENDED JUNE 30, 1998. THIS PROVISION WAS REVERSED DURING THE THREE-MONTH PRERIOD ENDED SEPTEMBER 30, 1998.

STOCKHOLDER AND INVESTOR INFORMATION >>

STOCK LISTING

The Company's common stock trades on the Nasdaq National Market tier of the Nasdaq Stock MarketSM under the symbol "DGII." At December 11, 1998, the number of holders of the Company's Common Stock was approximately 6,651 consisting of 333 record holders and approximately 6,318 stockholders whose stock is held by a bank, broker or other nominee.

High and low sale prices for each quarter during the years ended September 30, 1998 and 1997, as reported on the Nasdaq Stock Market, were as follows:

STOCK PRICES

1998	FIRST	SECOND	THIRD	FOURTH
High	$22.75	$28.62	$29.50	$28.25
Low	$13.75	$17.00	$19.50	$ 9.62

1997	FIRST	SECOND	THIRD	FOURTH
High	$18.75	$10.50	$11.75	$16.00
Low	$ 8.63	$ 6.75	$ 5.13	$ 9.88

DIVIDEND POLICY

The Company has never paid cash dividends on its common stock. The Board of Directors presently intends to retain all earnings for use in the Company's business and does not anticipate paying cash dividends in the foreseeable future.

The Company does not have a Dividend Reinvestment Plan or a Direct Stock Purchase Plan.

STOCKHOLDER INFORMATION

TRANSFER AGENT AND REGISTRAR

Norwest Bank Minnesota, N.A.
Norwest Shareowners Services
P.O. Box 64854
St. Paul, MN 55164-0854
651-450-4064
800-468-9716

LEGAL COUNSEL

Faegre & Benson LLP
2200 Norwest Center
Minneapolis, MN 55402-3901

INDEPENDENT PUBLIC ACCOUNTANTS

PricewaterhouseCoopers LLP
650 Third Avenue South
Minneapolis, MN 55402-4333

ANNUAL MEETING

The Company's Annual Meeting of Stockholders will be held on Wednesday, January 27, 1999, at 3:30 p.m., at the Marquette Hotel, 710 Marquette Avenue, Minneapolis, Minnesota.

INVESTOR RELATIONS

A copy of the Company's Form 10-K, filed with the Securities and Exchange Commission, is available free upon request. Contact:

Sue Mickelson
Investor Relations Administrator
Digi International Inc.
11001 Bren Road East
Minnetonka, MN 55343
or call 612-912-3104
e-mail request to: ir@dgii.com

EXHIBIT 21

SUBSIDIARIES OF THE COMPANY

Central Data Corporation

Digi International Asia Pte Ltd

Digi International GmbH

Digi International FSC

Digi International Israel Inc.

Digi International (HK) Ltd.

Digi International Australia PTY Ltd.

Digi International Limited

Digi International SARL

ITK International, Inc.

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the Form S-8 registration statements of Digi International Inc. for its Stock Option Plan (File No. 33-32956, File No. 33-38898, File No. 333-99 and File No. 333-23857); for its Employee Stock Purchase Plan (File No. 333-1821); and for its Non-Officer Stock Option Plan (File No. 33-57869) of our report dated December 11, 1998, on our audits of the consolidated financial statements of Digi International Inc. as of September 30, 1998 and 1997, and for the years ended September 30, 1998, 1997 and 1996, which report is included in or incorporated by reference in this Annual Report on Form 10-K.

Minneapolis, Minnesota
December 29, 1998

/s/ PricewaterhouseCoopers LLP

EXHIBIT 23.2

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-8 Registration Statement (File No. 333-1821) of Digi International Inc. for its Employee Stock Purchase Plan; and Form S-8 Registration Statement (File No. 33-57869) of Digi International Inc. for its Non-Officer Stock Option 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 Form 10-K of Digi International Inc. for the fiscal year ended September 30, 1998.

/s/ Ernst & Young LLP

Minneapolis, MN
December 24, 1998

EXHIBIT 24

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 William C. Nolte, 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 24th of November, 1998.

/s/ John P. Schinas

John P. Schinas

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

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IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 24th of November, 1998.

/s/ Robert S. Moe

Robert S. Moe

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

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/s/ Willis K. Drake

Willis K. Drake

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

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IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 24th of November, 1998.

/s/ David Stanley

David Stanley

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

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IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 24th of November, 1998.

/s/ Richard E. Eichhorn

Richard E. Eichhorn

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

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IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 24th of November, 1998.

/s/ Mykola Moroz

Mykola Moroz

YEAR
SEP-30-1998
OCT-01-1997
SEP-30-1998
10,335,368
0
53,618,657
5,069,512
27,365,924
92,410,378
51,999,720
18,008,797
160,734,667
54,514,657
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0
0
157,910
94,662,654
160,734,667
182,931,670
182,931,670
88,539,156
70,254,583
41,570,000
0
0
(12,913,783)
9,745,088
(22,658,871)
0
0
0
(22,658,871)
(1.65)
(1.65)

Acquired in-process research and development $39,200,000, Write-off of investment in AetherWorks $1,350,000, Restructuring $1,020,000.