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

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**FORM 10-Q**

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

For the quarterly period ended: **March 31, 2007**

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

(State or other jurisdiction of  
incorporation or organization)

41-1532464

(I.R.S. Employer  
Identification Number)

11001 Bren Road East  
Minnetonka, Minnesota

(Address of principal executive offices)

55343

(Zip Code)

(952) 912-3444

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the 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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

On April 30, 2007, there were 25,250,712 shares of the registrant's \$.01 par value Common Stock outstanding.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

DIGI INTERNATIONAL INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	Three months ended March 31,		Six months ended March 31,	
	2007	2006	2007	2006
	(in thousands, except per common share data)			
Net sales	\$ 42,855	\$ 34,380	\$ 84,666	\$ 67,756
Cost of sales (exclusive of amortization of purchased and core technology shown separately below)	19,215	14,894	37,865	28,904
Amortization of purchased and core technology	1,129	1,168	2,277	2,336
Gross profit	22,511	18,318	44,524	36,516
Operating expenses:				
Sales and marketing	8,427	6,802	16,585	13,553
Research and development	6,068	5,011	12,040	9,825
General and administrative	3,302	3,293	6,880	7,047
Total operating expenses	17,797	15,106	35,505	30,425
Operating income	4,714	3,212	9,019	6,091
Other income (expense):				
Interest income	777	643	1,573	1,059
Interest expense	(18)	(27)	(43)	(68)
Other expense	—	(62)	—	(105)
Total other income, net	759	554	1,530	886
Income before income taxes	5,473	3,766	10,549	6,977
Income tax provision	1,876	1,199	3,150	2,227
Net income	\$ 3,597	\$ 2,567	\$ 7,399	\$ 4,750
Net income per common share:				
Basic	\$ 0.14	\$ 0.11	\$ 0.29	\$ 0.21
Diluted	\$ 0.14	\$ 0.11	\$ 0.28	\$ 0.20
Weighted average common shares, basic	25,186	23,001	25,131	22,890
Weighted average common shares, diluted	25,959	23,687	25,976	23,609

The accompanying notes are an integral part of the condensed consolidated financial statements.

**DIGI INTERNATIONAL INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

	March 31, 2007	September 30, 2006
	(in thousands, except share data)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 17,186	\$ 15,674
Marketable securities	52,702	43,207
Accounts receivable, net	20,772	20,305
Inventories	23,472	21,911
Other	4,951	5,528
Total current assets	119,083	106,625
Property, equipment and improvements, net	19,702	19,488
Identifiable intangible assets, net	27,759	31,341
Goodwill	65,610	65,841
Other	2,119	2,026
Total assets	<u>\$ 234,273</u>	<u>\$ 225,321</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Capital lease obligations, current portion	\$ 376	\$ 381
Accounts payable	5,800	6,748
Income taxes payable	6,555	4,712
Accrued expenses:		
Compensation	5,309	5,851
Other	3,726	5,592
Total current liabilities	21,766	23,284
Capital lease obligations, net of current portion	532	725
Net deferred tax liabilities	6,812	7,482
Total liabilities	<u>29,110</u>	<u>31,491</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value; 2,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$.01 par value; 60,000,000 shares authorized; 27,894,836 and 27,748,640 shares issued and outstanding	279	277
Additional paid-in capital	167,762	164,782
Retained earnings	54,408	47,009
Accumulated other comprehensive income	1,580	940
Treasury stock, at cost, 2,667,367 and 2,711,496 shares	(18,866)	(19,178)
Total stockholders' equity	205,163	193,830
Total liabilities and stockholders' equity	<u>\$ 234,273</u>	<u>\$ 225,321</u>

The accompanying notes are an integral part of the condensed consolidated financial statements.

**DIGI INTERNATIONAL INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	Six months ended March 31,	
	2007	2006
	(in thousands)	
<b>Operating activities:</b>		
Net income	\$ 7,399	\$ 4,750
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property, equipment and improvements	1,263	1,272
Amortization of identifiable intangible assets and other assets	3,867	3,825
Excess tax benefits from stock-based compensation	(155)	(406)
Stock-based compensation expense	1,504	1,163
Deferred income taxes	(722)	(1,256)
Other	164	(533)
Changes in operating assets and liabilities:		
Accounts receivable	(162)	(507)
Inventories	(1,737)	(685)
Other assets	572	(157)
Accounts payable and accrued expenses	(3,022)	(2,375)
Income taxes payable	2,298	3,004
Net cash provided by operating activities	<u>11,269</u>	<u>8,095</u>
<b>Investing activities:</b>		
Purchase of held-to-maturity marketable securities	(40,387)	(26,347)
Proceeds from maturities of held-to-maturity marketable securities	30,892	19,214
Contingent purchase price payments related to business acquisitions	(781)	—
Proceeds from the sale of property, equipment, improvements	4	—
Purchase of property, equipment, improvements and certain other intangible assets	<u>(1,486)</u>	<u>(894)</u>
Net cash used in investing activities	<u>(11,758)</u>	<u>(8,027)</u>
<b>Financing activities:</b>		
Payments on capital lease obligations and long-term debt	(198)	(256)
Excess tax benefits from stock-based compensation	155	406
Proceeds from stock option plan transactions	1,201	2,673
Proceeds from employee stock purchase plan transactions	<u>493</u>	<u>359</u>
Net cash provided by financing activities	<u>1,651</u>	<u>3,182</u>
Effect of exchange rate changes on cash and cash equivalents	350	(550)
Net increase in cash and cash equivalents	1,512	2,700
Cash and cash equivalents, beginning of period	15,674	12,990
Cash and cash equivalents, end of period	<u>\$ 17,186</u>	<u>\$ 15,690</u>

The accompanying notes are an integral part of the condensed consolidated financial statements.

**DIGI INTERNATIONAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**1. BASIS OF PRESENTATION OF UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The interim unaudited condensed consolidated financial statements included in this Form 10-Q have been prepared by Digi International Inc. (the “Company,” “Digi,” “we,” “our,” or “us”) pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures, normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted, pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto, including the summary of significant accounting policies, presented in our 2006 Annual Report on Form 10-K as filed with the SEC.

The condensed consolidated financial statements presented herein reflect, in the opinion of management, all adjustments which consist only of normal, recurring adjustments necessary for a fair statement of the condensed consolidated financial position and the condensed consolidated results of operations and cash flows for the periods presented. The condensed consolidated results of operations for any interim period are not necessarily indicative of results for the full year. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

*Recently Issued Accounting Pronouncements*

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“FAS 157”). FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of FAS 157 are effective for the fiscal year beginning October 1, 2008. We are currently evaluating the impact of the provisions of FAS 157 on our consolidated financial statements and do not believe the impact of the adoption will be material.

In February 2007, the FASB issued FASB Statement No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115” (“SFAS 159”). This Statement provides companies with an option to measure, at specified election dates, many financial instruments and certain other items at fair value that are not currently measured at fair value. A company that adopts SFAS 159 will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This Statement is effective for fiscal years beginning after November 15, 2007, which for us is the first quarter of fiscal 2009. We are currently evaluating the impact that SFAS 159 could have on our consolidated financial statements.

In July 2006, the FASB issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109” (“FIN 48”). FIN 48 prescribes a recognition threshold and measurement process for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for us beginning October 1, 2007. We are in the process

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****1. BASIS OF PRESENTATION OF UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

of determining the effect, if any, that the adoption of FIN 48 will have on our consolidated financial statements. However, we expect to reclassify a portion of our unrecognized tax benefits from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date.

**2. NET INCOME PER COMMON SHARE**

Basic net income per common share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares of our stock result from dilutive common stock options and shares purchased through the employee stock purchase plan.

The following table is a reconciliation of the numerators and denominators in the net income per common share calculations (in thousands, except per common share data):

	<u>Three months ended March 31,</u>		<u>Six months ended March 31,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
<b>Numerator:</b>				
Net income	<u>\$ 3,597</u>	<u>\$ 2,567</u>	<u>\$ 7,399</u>	<u>\$ 4,750</u>
<b>Denominator:</b>				
Denominator for basic net income per common share — weighted average shares outstanding	25,186	23,001	25,131	22,890
<b>Effect of dilutive securities:</b>				
Employee stock options and employee stock purchase plan	<u>773</u>	<u>686</u>	<u>845</u>	<u>719</u>
Denominator for diluted net income per common share — adjusted weighted average shares	<u>25,959</u>	<u>23,687</u>	<u>25,976</u>	<u>23,609</u>
Net income per common share, basic	<u>\$ 0.14</u>	<u>\$ 0.11</u>	<u>\$ 0.29</u>	<u>\$ 0.21</u>
Net income per common share, diluted	<u>\$ 0.14</u>	<u>\$ 0.11</u>	<u>\$ 0.28</u>	<u>\$ 0.20</u>

Potentially dilutive shares related to stock options to purchase 1,545,505 and 1,105,834 common shares for the three and six month periods ended March 31, 2007, respectively, and potentially dilutive shares related to stock options to purchase 1,354,782 common shares for both the three and six month periods ended March 31, 2006, respectively, were not included in the computation of diluted earnings per common share because the options' exercise prices were greater than the average market price of common shares and, therefore, their effect would be anti-dilutive.

**3. COMPREHENSIVE INCOME**

Comprehensive income is comprised of net income and foreign currency translation adjustments. Foreign currency translation adjustments are charged or credited to accumulated other comprehensive income



**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****3. COMPREHENSIVE INCOME (CONTINUED)**

within stockholders' equity. Comprehensive income was as follows (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2007	2006	2007	2006
Net income	\$ 3,597	\$ 2,567	\$ 7,399	\$ 4,750
Foreign currency translation gain (loss)	261	(74)	640	(328)
Comprehensive income	<u>\$ 3,858</u>	<u>\$ 2,493</u>	<u>\$ 8,039</u>	<u>\$ 4,422</u>

**4. STOCK-BASED COMPENSATION**

Stock-based awards are granted under the terms of the 2000 Omnibus Stock Plan as Amended and Restated as of November 27, 2006 (the Omnibus Plan) which was ratified on January 22, 2007 at the Annual Meeting of Stockholders, as well as our Stock Option Plan as Amended and Restated as of November 27, 2006 (the Stock Option Plan) and Non-Officer Stock Option Plan as Amended and Restated as of November 27, 2006 (the Non-Officer Plan), both of which expired during the first quarter of fiscal 2007. Additional awards cannot be made under the Stock Option Plan or the Non-Officer Plan. The authority to grant options under all of our plans and set other terms and conditions rests with the Compensation Committee of the Board of Directors.

The Stock Option Plan and the Non-Officer Plan include nonstatutory stock options (NSOs) and the Stock Option Plan also includes incentive stock options (ISOs) to employees and others who provide services to us, including consultants, advisers and directors. Options granted under these plans generally vest over a four year service period and will expire if unexercised after ten years from the date of grant. The exercise price for ISOs and non-employee director options granted under the Stock Option Plan is set at the fair market value of our common stock based on the closing price on the date of grant. The exercise price for NSOs granted under the Stock Option Plan or the Non-Officer Plan is set by the Compensation Committee of the Board of Directors and is not less than 50% of the fair market value based on the closing price on the date of grant.

The Omnibus Plan authorizes the issuance of up to 3,250,000 common shares in connection with awards of stock options, stock appreciation rights, restricted stock, performance units or stock awards. Eligible participants include our employees, non-employee directors, consultants and advisors. Awards may be granted under the Omnibus Plan until November 27, 2016. Options under the Omnibus Plan can be granted as either ISOs or NSOs. The exercise price shall be determined by our Compensation Committee but shall not be less than the fair market value of our common stock based on the closing price on the date of grant.

Additionally, we have outstanding stock options for shares of our stock under various plans assumed in connection with its prior acquisition of NetSilicon, Inc. (the Assumed Plans). Additional awards cannot be made by us under the Assumed Plans.

Also, we sponsor an Employee Stock Purchase Plan as Amended and Restated as of November 27, 2006 (the Purchase Plan), covering all domestic employees with at least 90 days of continuous service and who are customarily employed at least 20 hours per week. 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. The Purchase Plan was ratified on January 22, 2007

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**4. STOCK-BASED COMPENSATION (CONTINUED)**

at the Annual Meeting of Stockholders and provides for the issuance of up to 1,750,000 shares of our Common Stock that may be purchased under the plan.

Effective October 1, 2005 we adopted Statement of Financial Accounting Standard No. 123 as amended, (FAS No. 123R), using the modified prospective method of application. Under this method, compensation expense is recognized both for (i) awards granted, modified or settled subsequent to September 30, 2005 and (ii) the nonvested portion of awards granted prior to October 1, 2005.

Stock-based compensation expense (pre-tax) is included in the consolidated results of operations as follows (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2007	2006	2007	2006
Cost of sales	\$ 36	\$ 23	\$ 67	\$ 43
Sales and marketing	267	193	486	319
Research and development	182	142	331	269
General and administrative	254	274	620	532
<b>Total stock-based compensation</b>	<b>\$ 739</b>	<b>\$ 632</b>	<b>\$ 1,504</b>	<b>\$ 1,163</b>

A summary of option activity under the Plans as of March 31, 2007 and changes during the six months then ended is presented below (in thousands, except per common share amounts):

	Available for Grant	Options Outstanding	Weighted Average Exercise Price per Common Share
Balances, September 30, 2006	597	4,240	\$ 10.54
Additional shares approved for grant	2,500	—	—
Granted	(564)	564	13.29
Exercised	—	(146)	8.21
Cancelled	49	(49)	11.32
Balances, March 31, 2007	2,582	4,609	\$ 10.94
Exercisable at March 31, 2007		3,454	\$ 10.32

The intrinsic value of an option is the amount by which the fair value of the underlying stock exceeds its exercise price. The total intrinsic value of all options exercised during the six months ended March 31, 2007 was \$0.8 million. The weighted average fair value of options granted during the six months ended March 31, 2007 and 2006 was \$5.66 and \$5.80, respectively, and 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:

	Six months ended March 31,	
	2007	2006
Risk free interest rate	4.44% - 4.80%	4.28% - 4.52%
Expect option holding period	3 - 5 years	3 - 5 years
Expected volatility	38% - 52%	50% - 60%
Weighted average volatility	48%	55%
Expected dividend yield	0	0

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**4. STOCK-BASED COMPENSATION (CONTINUED)**

We use historical data to estimate pre-vesting forfeiture rates. The pre-vesting forfeiture rate used in the second quarter of fiscal 2007 was 2.5%. As of March 31, 2007 the total unrecognized compensation cost related to nonvested stock-based compensation arrangements net of expected forfeitures was \$6.5 million and the related weighted average period over which it is expected to be recognized is approximately 2.7 years.

**5. ACQUISITIONS**

**MaxStream, Inc.**

On July 27, 2006, we acquired MaxStream, Inc. (MaxStream), a privately held corporation and a leader in the wireless device networking market. The total purchase price of \$40.5 million included \$19.8 million in cash (excluding cash acquired of \$3.7 million) and \$20.7 million in common stock, in exchange for all outstanding shares of MaxStream's preferred and common stock and outstanding stock options. This purchase consideration includes an adjustment of \$0.6 million pertaining to the closing working capital of MaxStream as of July 27, 2006. We did not replace MaxStream's outstanding options with Digi options. The value of our common stock was based on a per share value of \$12.35, calculated as the average market price of the common stock during the two business days immediately preceding July 27, 2006 when the parties reached agreement on terms and announced the acquisition.

Cash in the amount of \$1.925 million and 165,090 shares of common stock have been deposited to an escrow fund established at Wells Fargo Bank, National Association. These amounts will be held in escrow for a period not to exceed one year from the date of closing to satisfy possible claims that may arise pursuant to specific representation and warranty sections of the merger agreement. The escrowed amounts of cash and stock have been included in the determination of the purchase consideration on the date of acquisition because our management believes the outcome of the representation and warranty matters is reasonably determinable.

The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation was adjusted by \$0.4 million in March 2007 resulting in an increase in working capital and a reduction in goodwill due to the filing of an amended final tax return for MaxStream. The adjusted purchase price allocation resulted in goodwill of \$26.0 million and a charge of \$2.0 million for acquired in-process research and development. We believe that the acquisition resulted in the recognition of goodwill primarily because MaxStream's wireless technologies and products significantly expand our wireless offering, covering both short and medium range distances using embedded modules and boxed/package solutions and provide the capability to provide our customers end-to-end wireless solutions.

The following unaudited pro forma condensed consolidated results of operations have been prepared as if the acquisition of MaxStream had occurred as of October 1, 2005. Pro forma adjustments include amortization of identifiable intangible assets associated with the MaxStream acquisition. Had we acquired MaxStream as of October 1, 2005, net sales, net income and net income per share would have changed to the pro forma amounts below (in thousands, except per common share amounts):

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

5. ACQUISITIONS (CONTINUED)

	Three months ended March 31, 2006		Six months ended March 31, 2006	
	Pro forma	As Reported	Pro forma	As Reported
Net sales	\$37,471	\$34,380	\$74,080	\$67,756
Net income	\$ 2,461	\$ 2,567	\$ 4,670	\$ 4,750
Net income per common share, basic	\$ 0.10	\$ 0.11	\$ 0.19	\$ 0.21
Net income per common share, diluted	\$ 0.10	\$ 0.11	\$ 0.18	\$ 0.20

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the acquisition occurred as of the beginning of fiscal 2006, nor are they necessarily indicative of the results that will be obtained in the future.

6. SELECTED BALANCE SHEET DATA (in thousands)

	March 31, 2007	September 30, 2006
Accounts receivable, net:		
Accounts receivable	\$ 21,251	\$ 20,800
Less allowance for doubtful accounts	479	495
	<u>\$ 20,772</u>	<u>\$ 20,305</u>
Inventories:		
Raw materials	\$ 17,874	\$ 16,491
Work in process	1,074	606
Finished goods	4,524	4,814
	<u>\$ 23,472</u>	<u>\$ 21,911</u>
Other accrued expenses:		
Product warranty accrual	\$ 1,006	\$ 1,104
Accrued professional fees	539	879
Other accrued expenses	2,181	3,609
	<u>\$ 3,726</u>	<u>\$ 5,592</u>

Inventories are stated at the lower of cost or market value, with cost determined using the first-in, first-out method.

7. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS

Amortized identifiable intangible assets were comprised of the following (in thousands):

	March 31, 2007			September 30, 2006		
	Gross carrying amount	Accum. amort.	Net	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	\$ 48,057	\$ (33,790)	\$ 14,267	\$ 48,022	\$ (31,492)	\$ 16,530
License agreements	2,440	(2,090)	350	2,440	(1,890)	550
Patents and trademarks	7,786	(3,365)	4,421	7,608	(2,837)	4,771
Customer maintenance contracts	700	(359)	341	700	(324)	376
Customer relationships	11,531	(3,151)	8,380	11,470	(2,356)	9,114
Total	<u>\$ 70,514</u>	<u>\$ (42,755)</u>	<u>\$ 27,759</u>	<u>\$ 70,240</u>	<u>\$ (38,899)</u>	<u>\$ 31,341</u>

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****7. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS (CONTINUED)**

Amortization expense was \$1.9 million and \$1.8 million for the three months ended March 31, 2007 and 2006, respectively, and \$3.8 million and \$3.6 million for the six months ended March 31, 2007 and 2006, respectively.

Estimated amortization expense related to identifiable intangible assets for the remainder of fiscal 2007 and the five succeeding fiscal years is as follows (in thousands):

2007 (six months)	\$3,769
2008	5,375
2009	4,036
2010	3,640
2011	3,070
2012	2,514

The changes in the carrying amount of goodwill were as follows (in thousands):

	Six months ended March 31,	
	2007	2006
Beginning balance, October 1	\$ 65,841	\$ 38,675
Purchase price adjustment — MaxStream	(374)	—
Purchase price adjustment — FS Forth	—	(147)
Foreign currency translation adjustment	143	2
Ending balance, March 31	<u>\$ 65,610</u>	<u>\$ 38,530</u>

During the six months ended March 31, 2007, goodwill related to the purchase of MaxStream, acquired during fiscal 2006, was reduced by \$0.4 million to reflect additional working capital associated with the filing of an amended final tax return. During the six months ended March 31, 2006, the purchase price of FS Forth, acquired in fiscal year 2005, was reduced as a result of a change in certain tax liabilities, as defined in the purchase agreement. An accrued liability was recorded in September 2006 for \$0.8 million as contingent consideration based on the achievement of the milestones identified in the merger agreement. The payment of \$0.8 million was made in October 2006. Future contingent consideration of up to \$1.2 million may be payable to FS Forth based upon the achievement of certain milestones (see Note 10).

**8. INCOME TAXES**

Income taxes have been provided for at an effective rate of 29.9% for the six month period ended March 31, 2007 compared to an effective rate of 31.9% for the six month period ended March 31, 2006. On December 9, 2006, Congress passed H.R. 6111, the "Tax Relief and Health Care Act of 2006", which included an extension of the research credit that previously expired on December 31, 2005. As a result of the extension, we recorded a benefit of \$0.5 million in the first quarter of fiscal 2007 for research and development credits earned during the last three fiscal quarters of 2006. The additional research and development credits were accounted for as a discrete event in the first quarter of fiscal 2007. The effective tax rates for both the first six months of fiscal 2007 and 2006 are lower than the U.S. statutory rate of 35.0% primarily due to the utilization of income tax credits and the combined phase-out of the extraterritorial income exclusion and the phase-in of the U.S. domestic production activities deduction.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****8. INCOME TAXES (CONTINUED)**

We expect our annualized 2007 income tax rate to be in a range of 33% to 33.5%, which includes the additional benefit related to the research and development credit.

**9. FINANCIAL GUARANTEES**

In general, we warrant our products to be free from defects in material and workmanship under normal use and service for a period of up to five years from the date of receipt. We have the option to repair or replace products we deem defective with regard to material or workmanship. Estimated warranty costs are accrued in the period that the related revenue is recognized based upon an estimated average per unit repair or replacement cost applied to the estimated number of units under warranty. These estimates are based upon historical warranty incidence and are evaluated on an ongoing basis to ensure the adequacy of the warranty reserve. The following table summarizes the activity associated with the product warranty accrual (in thousands):

	Three months ended March 31,			Balance at March 31
	Balance at January 1	Warranties issued (1)	Settlements made	
2007	\$ 964	\$224	\$(182)	\$1,006
2006	\$1,068	\$109	\$(127)	\$1,050

  

	Six months ended March 31,			Balance at March 31
	Balance at October 1	Warranties issued (1)	Settlements made	
2007	\$1,104	\$309	\$(407)	\$1,006
2006	\$1,187	\$108	\$(245)	\$1,050

(1) Warranties issued includes a decrease in estimate adjustment of \$132,000 and \$117,000 in the first quarter of fiscal 2007 and 2006, respectively.

We are not responsible and do not warrant that custom software versions created by original equipment manufacturer (OEM) customers based upon our software source code will function in a particular way, will conform to any specifications or are fit for any particular purpose and do not indemnify these customers from any third-party liability as it relates to or arises from any customization or modifications made by the OEM customer.

**10. CONTINGENCIES***Contingent obligations*

Effective April 1, 2005, we acquired FS Forth-Systeme GmbH/Sistemas Embebidos S.A. (collectively referred to as FS Forth) from Embedded Solutions AG of Germany. The purchase price of \$5.6 million in cash includes \$0.8 million of contingent consideration paid in October 2006, based on the achievement of milestones identified in the merger agreement. Additional contingent consideration of up to \$1.2 million is payable on October 1, 2007 if FS Forth achieves certain future milestones.

*Legal Proceedings*

On April 19, 2002, a consolidated amended class action complaint was filed in the United States District Court for the Southern District of New York asserting claims relating to the initial public offering (IPO) of

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**10. CONTINGENCIES (CONTINUED)**

NetSilicon and approximately 300 other public companies. The complaint names us as defendants along with NetSilicon, certain of its officers and certain underwriters involved in NetSilicon's IPO, among numerous others, and asserts, among other things, that NetSilicon's IPO prospectus and registration statement violated federal securities laws because they contained material misrepresentations and/or omissions regarding the conduct of NetSilicon's IPO underwriters in allocating shares in NetSilicon's IPO to the underwriters' customers. We believe that the claims against the NetSilicon defendants are without merit and have defended the litigation vigorously. Pursuant to a stipulation between the parties, the two named officers were dismissed from the lawsuit, without prejudice, on October 9, 2002.

In June 2003, we elected to participate in a proposed settlement agreement with the plaintiffs in this litigation. If ultimately approved by the Court, this proposed settlement would result in a dismissal, with prejudice, of all claims in the litigation against us and against any of the other issuer defendants who elect to participate in the proposed settlement, together with the current or former officers and directors of participating issuers who were named as individual defendants.

Consummation of the proposed settlement remains conditioned upon obtaining approval by the Court. On September 1, 2005, the Court preliminarily approved the proposed settlement and directed that notice of the terms of the proposed settlement be provided to class members. Thereafter, the Court held a fairness hearing on April 24, 2006, at which objections to the proposed settlement were heard. After the fairness hearing, the Court took under advisement whether to grant final approval to the proposed settlement.

On December 5, 2006, the U.S. Court of Appeals for the Second Circuit issued a decision in In re Initial Public Offering Securities Litigation that six purported class action lawsuits containing allegations substantially similar to those asserted against us may not be certified as class actions due, in part, to the Appeals Court's determination that individual issues of reliance and knowledge would predominate over issues common to the proposed classes. On January 8, 2007, the plaintiffs filed a petition seeking rehearing en banc of the Second Circuit Court of Appeals' December 5, 2006 ruling. U.S. District Judge Scheindlin has ordered that all proceedings in the consolidated cases brought against us and against the roughly 300 other issuers sued in substantially similar cases (including proceedings relating to the proposed settlement) will be stayed pending the ruling by the Court of Appeals on whether to entertain that petition for rehearing. As a result of that filing, the impact, if any, of the Court of Appeals' ruling on the viability of the proposed settlement cannot yet be determined.

If the proposed settlement is not consummated, we intend to continue to defend the litigation vigorously. The litigation process is inherently uncertain and unpredictable, however, there can be no guarantee as to the ultimate outcome of this pending lawsuit. We maintain liability insurance for such matters and expect that the liability insurance will be adequate to cover any potential unfavorable outcome, less the applicable deductible amount of \$250,000 per claim. As of March 31, 2007, we have accrued a liability for the deductible amount of \$250,000 which we believe reflects the amount of loss that is probable. In the event we have losses that exceed the limits of the liability insurance, such losses could have a material effect on our business, or our consolidated results of operations or financial condition.

In the normal course of business, we are subject to various claims and litigation, including patent infringement and intellectual property claims. Our management expects that these various claims and litigation will not have a material adverse effect on our consolidated results of operations or financial condition.

## **ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

This Form 10-Q contains certain statements that are “forward-looking statements” as that term is defined under the Private Securities Litigation Reform Act of 1995, and within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

The words “believe,” “anticipate,” “intend,” “estimate,” “target,” “may,” “will,” “expect,” “plan,” “project,” “should,” or “continue” or the negative thereof or other expressions, which are predictions of or indicate future events and trends and which do not relate to historical matters, identify forward-looking statements. Such statements are based on information available to our management as of the time of such statements and relate to, among other things, expectations of the business environment in which we operate, project our future performance, perceived opportunities in the market and statements regarding our mission and vision. Forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Our future operating results and performance trends may be affected by a number of factors, including, without limitation, those described under Item 1A, “Risk Factors” in our Annual Report on Form 10-K for the year ended September 30, 2006. Those risk factors, and other risks, uncertainties and assumptions identified from time to time in our filings with the Securities and Exchange Commission, including without limitation, our quarterly reports on Form 10-Q and our registration statements, could cause our actual future results to differ from those projected in the forward-looking statements as a result of the factors set forth in our various filings with the Securities and Exchange Commission and of changes in general economic conditions, changes in interest rates and/or exchange rates and changes in the assumptions used in making such forward-looking statements.

### **CRITICAL ACCOUNTING POLICIES**

A description of our critical accounting policies was provided in the Management’s Discussion and Analysis of Financial Condition and Results of Operations section of the our Annual Report on Form 10-K for the year ended September 30, 2006.

### **OVERVIEW**

We operate in the communications technology industry, which 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. We place a high priority on development of innovative reliable products that provide differentiated features and functions and allow for ease of integration with customers’ applications. We compete for customers on the basis of existing and planned product features, company reputation, brand recognition, technical support, relationships with partners, quality and reliability, product development capabilities, price and availability.



**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**OVERVIEW (CONTINUED)**

We plan to extend our current product lines with next generation commercial grade device networking products and technologies for targeted vertical markets, including but not limited to point of sale, industrial automation, office automation, medical and building controls. We believe that there is a market trend of device connectivity in these vertical commercial applications that will require communications intelligence or connectivity to the network or the Internet. These devices will be used for basic data communications, management, monitoring and control, and maintenance. We believe that we are well positioned to leverage our current products and technologies to take advantage of this market trend.

We anticipate that growth in the future will result from both products that are developed internally as well as from acquired products, and that the growth rate from products developed internally will increase as the multi-port serial adapters and the network interface cards (NICs) near the end of their product life cycles. Following are the business highlights for the three and six months ended March 31, 2007 and 2006:

- Net sales of \$42.9 million for the three months ended March 31, 2007 represented an increase of \$8.5 million, or 24.7%, compared to net sales of \$34.4 million for the three months ended March 31, 2006. Net sales of \$84.7 million for the six months ended March 31, 2007, represented an increase of \$16.9 million, or 25.0%, compared to net sales of \$67.8 million for the six months ended March 31, 2006.
- Gross profit margin decreased to 52.5% compared to 53.3% for the three months ended March 31, 2007 and 2006, respectively. Gross profit margin decreased to 52.6% compared to 53.8% for the six months ended March 31, 2007 and 2006, respectively.
- Operating expenses as a percent of net sales decreased by 2.5 and 3.0 percentage points for the three months and six months ended March 31, 2007 compared to the same periods in 2006 as we continue to focus on controlling expenses while increasing revenue. Total operating expenses for the three months ended March 31, 2007 were \$17.8 million, or 41.5% of net sales, compared to \$15.1 million, or 44.0% of net sales, for the three months ended March 31, 2006, an increase of \$2.7 million. Total operating expenses for the six months ended March 31, 2007 were \$35.5 million, or 41.9% of net sales, compared to \$30.4 million, or 44.9% of net sales, for the six months ended March 31, 2006, an increase of \$5.1 million.
- Net income increased \$1.0 million to \$3.6 million, or \$0.14 per diluted share, for the three months ended March 31, 2007, compared to \$2.6 million, or \$0.11 per diluted share, for the three months ended March 31, 2006. Net income increased \$2.6 million to \$7.4 million, or \$0.28 per diluted share, for the six months ended March 31, 2007, compared to \$4.8 million, or \$0.20 per diluted share, for the six months ended March 31, 2006. As a result of the extension of the research and development credit for two additional years beyond calendar 2005, a benefit for research and development credits earned during the last three quarters of fiscal 2006 was recorded during the first quarter of fiscal 2007, resulting in an additional tax benefit of \$0.5 million or \$0.02 per diluted share.
- Our net working capital position (total current assets less total current liabilities) increased \$14.0 million to \$97.3 million during the six months ended March 31, 2007 and our current ratio was 5.5 to 1 as of that date. Cash and cash equivalents and marketable securities increased \$11.0 million to \$69.9 million during the period. At March 31, 2007, we had no debt other than capital lease obligations.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**
**CONSOLIDATED RESULTS OF OPERATIONS**

The following table sets forth selected information derived from our interim condensed consolidated statements of operations expressed in dollars, as a percentage of net sales and as a percentage of change from period-to-period for the periods indicated (dollars in thousands):

	Three months ended March 31,				% increase (decrease)	Six months ended March 31,				% increase (decrease)
	2007		2006			2007		2006		
Net sales	\$42,855	100.0%	\$34,380	100.0%	24.7%	\$84,666	100.0%	\$67,756	100.0%	25.0%
Cost of sales (exclusive of amortization of purchased and core technology shown separately below)	19,215	44.9	14,894	43.3	29.0	37,865	44.7	28,904	42.7	31.0
Amortization of purchased and core technology	1,129	2.6	1,168	3.4	(3.3)	2,277	2.7	2,336	3.5	(2.5)
Gross profit	22,511	52.5	18,318	53.3	22.9	44,524	52.6	36,516	53.8	21.9
Operating expenses:										
Sales and marketing	8,427	19.7	6,802	19.8	23.9	16,585	19.6	13,553	20.0	22.4
Research and development	6,068	14.1	5,011	14.6	21.1	12,040	14.2	9,825	14.5	22.5
General and administrative	3,302	7.7	3,293	9.6	0.3	6,880	8.1	7,047	10.4	(2.4)
Total operating expenses	17,797	41.5	15,106	44.0	17.8	35,505	41.9	30,425	44.9	16.7
Operating income	4,714	11.0	3,212	9.3	46.8	9,019	10.7	6,091	8.9	48.1
Interest income and other, net	759	1.8	554	1.7	37.0	1,530	1.8	886	1.4	72.7
Income before income taxes	5,473	12.8	3,766	11.0	45.3	10,549	12.5	6,977	10.3	51.2
Income tax provision	1,876	4.4	1,199	3.5	56.5	3,150	3.8	2,227	3.3	41.4
Net income	\$ 3,597	8.4%	\$ 2,567	7.5%	40.1%	\$ 7,399	8.7%	\$ 4,750	7.0%	55.8%

**NET SALES**

Net sales for the three and six months ended March 31, 2007 were \$42.9 million and \$84.7 million compared to net sales of \$34.4 million and \$67.8 million for the three and six months ended March 31, 2006, or an increase of 24.7% and 25.0%, respectively. Net sales of products acquired as a result of the MaxStream acquisition, which was acquired on July 27, 2006, were \$5.0 million and \$9.6 million for the first three and six months of fiscal 2007.

The following summarizes our net sales for the periods indicated:

(\$ in thousands)	Three months ended March 31,				% increase (decrease)	Six months ended March 31,				% increase (decrease)
	2007		2006			2007		2006		
Non-embedded	\$24,445	57.0%	\$21,293	61.9%	14.8%	\$49,611	58.6%	\$40,628	60.0%	22.1%
Embedded	18,410	43.0	13,087	38.1	40.7	35,055	41.4	27,128	40.0	29.2
Total net sales	\$42,855	100.0%	\$34,380	100.0%	24.7%	\$84,666	100.0%	\$67,756	100.0%	25.0%

**Non-Embedded**

Net sales of network connected products, USB, cellular gateways and MaxStream non-embedded products increased net sales by \$5.0 million and \$11.1 million for the three and six months ended March 31, 2007 as

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**NET SALES (CONTINUED)**

compared to the three and six months ended March 31, 2006, respectively. Multi-port serial adapter products net sales declined by \$1.8 million and \$2.1 million for the three and six months ended March 31, 2007 compared to the same periods in the prior year as this product line continues to mature.

*Embedded*

Net sales of embedded modules and microprocessors increased by \$5.8 million and \$9.6 million for the three and six months ended March 31, 2007 compared to the three and six months ended March 31, 2006, respectively, due to market acceptance of embedded products and MaxStream modules. This was offset by a decline of \$0.5 million and \$1.7 million of NIC net sales for the three and six months ended March 31, 2007 as compared to the three and six months ended March 31, 2006, respectively, as these NICs are near the end of their product life cycle.

Fluctuation in foreign currency rates compared to the same periods one year ago had a favorable impact on net sales of \$0.7 million and \$1.2 million in the three and six month periods ended March 31, 2007.

**GROSS PROFIT**

Gross profit margin for both the three and six months ended March 31, 2007 was 52.5% compared to 53.3% and 53.8% for the three and six months ended March 31, 2006. The decrease in gross profit margin was primarily due to lower sales of high gross profit margin mature products and other product mix changes within both the embedded and non-embedded product categories.

We anticipate that our gross profit margins for the remainder of the fiscal year will be consistent with current levels. Gross profit margins include estimated amortization of purchased and core technology of 2.5 – 3.0 percentage points.

**OPERATING EXPENSES**

Total operating expenses for the three months ended March 31, 2007 were \$17.8 million, or 41.5% of net sales, compared with \$15.1 million, or 44.0% of net sales, for the three months ended March 31, 2006. Total operating expenses for the six months ended March 31, 2007 were \$35.5 million, or 41.9% of net sales, compared with \$30.4 million, or 44.9% of net sales, for the six months ended March 31, 2006. The increase in operating expenses is primarily attributable to the inclusion of operating expenses of \$1.4 million pertaining to MaxStream and \$1.4 million of variable compensation expenses related to the increase in revenue, partially offset by a \$0.7 million reduction in professional fees compared to the second quarter of fiscal 2006. Operating expenses as a percent of net sales decreased by 2.4 and 3.0 percentage points for the three months and six months ended March 31, 2007 compared to the same periods in 2006 as we continue to focus on controlling expenses while increasing revenue.

Sales and marketing expenses for the three months ended March 31, 2007 were \$8.5 million, or 19.7% of net sales, compared to \$6.8 million, or 19.8% of net sales, for the three months ended March 31, 2006. The increase of \$1.7 million in sales and marketing expenses for the three months ended March 31, 2007 compared to 2006 is primarily due to \$0.7 million as a result of the acquisition of MaxStream and an increase of \$0.7 million of salaries and incentive compensation related expenses associated with the increase in revenue. Sales and marketing expenses for the six months ended March 31, 2007 were \$16.6 million, or 19.6% of net sales, compared to \$13.6 million, or 20.0% of net sales, for the six months ended

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**OPERATING EXPENSES (CONTINUED)**

March 31, 2006. The net increase in sales and marketing expenses of \$3.0 million is primarily due to increased ongoing expenses of \$1.4 million as the result of the acquisition of MaxStream and an increase of \$1.3 million for salaries and incentive compensation related expenses.

Research and development expenses for the three months ended March 31, 2007 were \$6.0 million, or 14.1% of net sales, compared to \$5.0 million, or 14.6% of net sales, for the three months ended March 31, 2006. The increase in research and development expenses for the three months ended March 31, 2007 compared to 2006 is primarily due to increases of \$0.4 million as a result of the MaxStream acquisition, an increase of \$0.3 million for various chip development projects, and an increase of \$0.4 million for salaries and incentive compensation related expenses. Research and development expenses for the six months ended March 31, 2007 were \$12.0 million, or 14.2% of net sales, compared to \$9.8 million, or 14.5% of net sales, for the six months ended March 31, 2006. The increase in research and development expenses of \$2.2 million is due primarily to increased ongoing expenses of \$0.8 million as a result of the acquisition of MaxStream, an increase of \$0.8 million in salaries and incentive compensation related expenses and an increase of \$0.6 million pertaining to various chip development projects.

General and administrative expenses were \$3.3 million, or 7.7% of net sales, for the three months ended March 31, 2007 compared to \$3.3 million, or 9.6% of net sales, for the three months ended March 31, 2006. For the three months ended March 31, 2007 compared to 2006, general and administrative expenses increased by \$0.3 million due to primarily incentive compensation related expenses and \$0.3 million due to the MaxStream acquisition. These increases were offset by a \$0.7 million reduction in professional fees compared to the second quarter of fiscal 2006. General and administrative expenses were \$6.9 million, or 8.1% of net sales, for the six months ended March 31, 2007 compared to \$7.0 million, or 10.4% of net sales, for the six months ended March 31, 2006. The net decrease in general and administrative expenses of \$0.1 million was due primarily to decreased professional fees of \$1.3 million compared to the six months ended March 31, 2006, offset by increased ongoing expenses of \$0.7 million as a result of the MaxStream acquisition and \$0.3 million in incentive compensation related expenses.

**INTEREST INCOME AND OTHER, NET**

Interest income and other, net was \$0.7 million and \$1.5 million for the three and six months ended March 31, 2007 compared to \$0.6 million and \$0.9 million for the three and six months ended March 31, 2006, respectively. We realized interest income on marketable securities and cash and cash equivalents of \$1.6 million and \$1.1 million for the six month periods ended March 31, 2007 and 2006, respectively, due to higher average interest rates and an increase in the average invested balance. We earned an average interest rate of 5.1% for the six months ended March 31, 2007 compared to 3.9% for the six months ended March 31, 2006. The average invested balance for the six months ended March 31, 2007 and 2006 was \$58.7 million and \$49.3 million, respectively.

**INCOME TAXES**

Income taxes have been provided for at an effective rate of 29.9% for the six month period ended March 31, 2007 compared to an effective rate of 31.9% for the six month period ended March 31, 2006. On December 9, 2006, Congress passed H.R. 6111, the "Tax Relief and Health Care Act of 2006", which included an extension of the research credit that previously expired on December 31, 2005. As a result of

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**INCOME TAXES (CONTINUED)**

the extension, we recorded a benefit of \$0.5 million in the first quarter of fiscal 2007 for research and development credits earned during the last three fiscal quarters of 2006. The additional research and development credits were accounted for as a discrete event in the first quarter of fiscal 2007. The effective tax rates for both the first six months of fiscal 2007 and 2006 are lower than the U.S. statutory rate of 35.0% primarily due to the utilization of income tax credits and the combined phase-out of the extraterritorial income exclusion and the phase-in of the U.S. domestic production activities deduction.

We expect our annualized 2007 income tax rate to be in a range of 33% to 33.5%, which includes the additional benefit related to the research and development credit.

**LIQUIDITY AND CAPITAL RESOURCES**

We have financed our operations principally with funds generated from operations. At March 31, 2007, we had cash, cash equivalents and marketable securities of \$69.9 million compared to \$58.9 million at September 30, 2006. Our working capital (total current assets less total current liabilities) increased \$14.0 million to \$97.3 million at March 31, 2007 compared to \$83.3 million at September 30, 2006.

Net cash provided by operating activities was \$11.3 million and \$8.1 million for the six months ended March 31, 2007 and 2006, respectively, resulting in a net increase of \$3.2 million. This net increase is primarily due to an increase of \$2.6 million of net income and \$1.9 million for non-cash expenses, primarily related to stock-based compensation, deferred income taxes, and provisions for bad debts and product returns. Cash of \$1.1 million was used as a result of additional material purchases and production builds in order to fulfill order demand.

Net cash used in investing activities was \$11.8 million during the six months ended March 31, 2007 compared to net cash used by investing activities of \$8.0 million during the same period in the prior fiscal year, resulting in \$3.8 million of additional cash usage. This additional cash usage is due to a \$2.4 million increase in purchases of marketable securities, net of settlements, \$0.6 million related to purchases of property, equipment, improvements and certain other intangible assets, and \$0.8 million for contingent purchase price payments related to the FS Forth acquisition (see Note 10 to Condensed Consolidated Financial Statements). We anticipate total fiscal 2007 capital expenditures to approximate \$2.6 million.

We generated \$1.7 million from financing activities during the six months ended March 31, 2007 compared to \$3.2 million during the same period a year ago, primarily as a result of proceeds from stock option and employee stock purchase plan transactions in both periods, and the reflection of cash provided by the excess tax benefits related to the exercise of stock options.

The remaining increase in net cash of \$0.9 million for the comparable six month periods ended March 31, 2007 and 2006 is due to the effect of exchange rate changes in cash and cash equivalents, primarily due to the strengthening of the Euro.

Management believes that current financial resources, cash generated from operations and our potential capacity for additional debt and/or equity financing will be sufficient to fund operations in the foreseeable future.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)****LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)**

The following summarizes our contractual obligations at March 31, 2007 (in thousands):

	Payments due by fiscal period				
	Total	Less than 1 year	1-3 years	3-5 years	Thereafter
Operating leases	\$6,380	\$2,141	\$2,297	\$1,249	\$693
Capital leases	1,064	448	616	—	—
Total contractual cash obligations	\$7,444	\$2,589	\$2,913	\$1,249	\$693

The lease obligations summarized above relate to various operating lease agreements for office space and equipment. The capital leases summarized above are for manufacturing equipment located in Davis, California and Breisach, Germany. The table above excludes a potential \$1.2 million installment on October 1, 2007 of additional contingent purchase price payments related to the FS Forth acquisition if certain future milestones are achieved (see Note 10 to Condensed Consolidated Financial Statements).

**RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of FAS 157 are effective for the fiscal year beginning October 1, 2008. We are currently evaluating the impact of the provisions of FAS 157 on our consolidated financial statements and do not believe the impact of the adoption will be material.

In February 2007, the FASB issued FASB Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115" (SFAS 159). This Statement provides companies with an option to measure, at specified election dates, many financial instruments and certain other items at fair value that are not currently measured at fair value. A company that adopts SFAS 159 will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This Statement is effective for fiscal years beginning after November 15, 2007, which for us is the first quarter of fiscal 2009. We are currently evaluating the impact that SFAS 159 could have on our consolidated financial statements.

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement process for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for us beginning October 1, 2007. We are in the process of determining the effect, if any, that the adoption of FIN 48 will have on our consolidated financial statements. However, we expect to reclassify a portion of our unrecognized tax benefits from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**RISK FACTORS**

Multiple risk factors exist which could have a material effect on our operations, results of operations, profitability, financial position, liquidity and capital resources. These risk factors are more fully presented in our 2006 Annual Report on Form 10-K as filed with the SEC.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**INTEREST RATE RISK**

Our exposure to interest rate risk relates primarily to our investment portfolio. Investments are made in accordance with our investment policy and consist of high grade commercial paper and corporate bonds. We do not use derivative financial instruments to hedge against interest rate risk as all investments are held to maturity and the majority of our investments mature in less than a year. A change in interest rates would not have a material effect on our financial statements.

**FOREIGN CURRENCY RISK**

Our transactions are executed in the U.S. Dollar, Euro or Japanese Yen. As a result, we are exposed to foreign currency transaction risk associated with certain sales transactions being denominated in Euros or Japanese Yen, and foreign currency translation risk as the financial position and operating results of our foreign subsidiaries are translated into U.S. Dollars for consolidation. We have not implemented a hedging strategy to reduce foreign currency risk.

For the six months ended March 31, 2007 and 2006, we had approximately \$29.6 million and \$27.4 million, respectively, of net sales to foreign customers including export sales, of which \$14.5 million and \$10.8 million, respectively, were denominated in foreign currency, predominantly Euros. In future periods, a significant portion of sales will continue to be made in Euros.

The average monthly exchange rate for the Euro to the U.S. Dollar increased approximately 8.2% from 1.2014 to 1.3000 and the average monthly exchange rate for the Japanese Yen to the U.S. Dollar decreased from .0085 to .0084 for the first six months of fiscal year 2007 as compared to the same period one year ago. A 10.0% change from the first quarter fiscal 2007 average exchange rate for the Euro and Yen to the U.S. Dollar would have resulted in a 1.7% increase or decrease in net sales and a 1.3% increase or decrease in stockholders' equity. The above analysis does not take into consideration any pricing adjustments we may need to consider in response to changes in the exchange rate.

**CREDIT RISK**

We have some exposure to credit risk related to our accounts receivable portfolio. Exposure to credit risk is controlled through regular monitoring of customer financial status, credit limits and collaboration with sales management on customer contacts to facilitate payment.

**ITEM 4. CONTROLS AND PROCEDURES**

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”). Based on this evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act was recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including the principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The disclosures set forth in Note 10 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q are incorporated herein by reference.

**ITEM 1A. RISK FACTORS**

There have been no material changes in the risk factors provided in Part I, Item 1A of our 2006 Annual Report on Form 10-K as filed with the SEC on December 6, 2006.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

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

Our Annual Meeting of Stockholders was held on January 22, 2007. Of the 25,085,451 shares of Digi common stock entitled to vote at the meeting, 18,293,381 shares were present at the meeting in person or by proxy. The stockholders voted on the following:

- a) The following individuals designated by our Board of Directors as nominees for director were elected for a three-year term, with voting as follows:

<u>Nominee</u>	<u>Total Votes For</u>	<u>Withhold Authority</u>
Guy C. Jackson	17,084,727	1,208,654
Ahmed Nawaz	18,111,747	181,634

- b) Proposal to approve the Digi International Inc. 2000 Omnibus Stock Plan, as Amended and Restated as of November 27, 2006. The proposal passed on a vote of 12,648,703 in favor, 2,838,400 against, 28,802 abstentions and 2,777,476 broker non-votes.
- c) Proposal to approve the Digi International Inc. Employee Stock Purchase Plan, as Amended and Restated as of November 27, 2006. The proposal passed on a vote of 14,847,833 in favor, 646,568 against, 21,504 abstentions and 2,777,476 broker non-votes.
- d) Proposal to ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ended September 30, 2007. The proposal passed on a vote of 18,096,178 in favor, 170,512 against, 26,691 abstentions and no broker non-votes.

**ITEM 5. OTHER INFORMATION**

None

**PART II. OTHER INFORMATION**

**ITEM 6. EXHIBITS**

Exhibit No.	Description
3(a)	Restated Certificate of Incorporation of the Company, as amended (1)
3(b)	Amended and Restated By-Laws of the Company
4(a)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (2)
4(b)	Amendment dated January 26, 1999, to Share Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (3)
31(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certification

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- (1) 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)
  - (2) Incorporated by reference to Exhibit 1 to the Company's Registration Statement on Form 8-A dated June 24, 1998 (File No. 0-17972)
  - (3) Incorporated by reference to Exhibit 1 to Amendment 1 to the Company's Registration Statement on Form 8-A dated February 5, 1999 (File No. 0-17972)

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SIGNATURE

Pursuant to the requirements 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.

Date: May 8, 2007

By: /s/ Subramanian Krishnan  
Subramanian Krishnan  
Senior Vice President, Chief Financial Officer and  
Treasurer (Principal Financial and Accounting Officer)

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### EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Document Description</u>	<u>Form of Filing</u>
3(a)	Restated Certificate of Incorporation of the Company, as Amended (incorporated by reference to the corresponding exhibit number to the Company's Form 10-K for the year ended September 30, 1993 (File No. 0-17972))	Incorporated by Reference
3(b)	Amended and Restated By-Laws of the Company	Filed Electronically
4(a)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (incorporated by reference to Exhibit 1 to the Company's Registration Statement on Form 8-A dated June 24, 1998 (File No. 0-17972))	Incorporated by Reference
4(b)	Amendment dated January 26, 1999, to Share Rights Agreement, dated June 10, 1998 between Digi International Inc. and Wells Fargo Bank, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (incorporated by reference to Exhibit 1 to Amendment No. 1 to the Company's Registration Statement on Form 8-A dated February 5, 1999 (File No. 0-17972))	Incorporated by Reference
31(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed Electronically
31(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed Electronically
32	Section 1350 Certification	Filed Electronically

BY-LAWS OF  
DIGI INTERNATIONAL INC.  
AS AMENDED AND RESTATED AS OF APRIL 24, 2007

I. OFFICES

Section 1.01. Registered Office. The Corporation shall maintain a registered office and registered agent within the State of Delaware at such place within such State as may be designated from time to time by the Board of Directors of the Corporation.

Section 1.02. Other Offices. The Corporation also may have offices at such other places both within and without the State of Delaware as the Board of Directors may from time to time determine.

II. STOCKHOLDERS

Section 2.01. Place of Meetings. Meetings of stockholders may be held at the principal executive offices of the Corporation or at such other place, either within or without the State of Delaware, as may be designated by the Board of Directors or the chief executive officer of the Corporation.

Section 2.02. Annual Meetings. An annual meeting of stockholders shall be held in each calendar year for the election of directors on such date and at such time as shall be designated from time to time by the Board of Directors. Any other proper business may be transacted at the annual meeting, provided that such business is specified in the notice of meeting (or a supplement thereto) given by or at the direction of the Board of Directors, or brought before the meeting after written notice of a stockholder delivered to, or mailed to and received at, the principal executive offices of the Corporation not less than sixty (60) days prior to the date fixed for the annual meeting; provided, however, that in the event that less than seventy-five (75) days' prior public disclosure of the date of the meeting is given or made to stockholders, notice by the stockholder to be timely must be received not later than the close of business on the fifteenth (15th) day following the day on which such public disclosure was made. A stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual meeting (a) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (b) the name and record address of the stockholder proposing such business, (c) the class and number of shares of the Corporation which are beneficially owned by the stockholder, and (d) any material interest of the stockholder in such business.

Section 2.03. Special Meetings. Unless otherwise specifically provided by law or the Certificate of Incorporation, a special meeting of stockholders, for any purpose or purposes, may be called only by the Chairman or the President and shall be called by either such officer upon the written request of a majority of the Board of Directors or by a

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committee of the Board of Directors which has been duly designated by the Board of Directors, and whose powers and authority, as expressly provided in a resolution of the Board of Directors, include the power to call such meetings. Such request shall state the purpose or purposes of the proposed meeting. If the authorized officers fail to cause such meeting to be called within thirty (30) days after receipt of such request and held within ninety (90) days after receipt of such request, the directors making the request may call the meeting by giving notice as provided in these By-Laws at the expense of the Corporation. Business transacted at any special meeting shall be limited to the purposes stated in the notice of the meeting.

Section 2.04. Notice of Meetings. A written notice stating the place, date and hour of the meeting and, in the case of a special meeting, the purpose or purposes for which the meeting is called, shall be personally delivered or mailed, postage prepaid, not less than ten (10) nor more than sixty (60) days before the date of such meeting to each stockholder of record of the Corporation entitled to vote at such meeting at the stockholder's mailing address shown upon the records of the Corporation. Service of notice is complete upon mailing.

Section 2.05. Waiver of Notice. Notice of any annual or special meeting of stockholders may be waived either before, at or after such meeting in a writing signed by the person or persons entitled to the notice. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transacting of any business because the meeting is not lawfully called or convened.

Section 2.06. Quorum. At each meeting of stockholders, except where otherwise provided by law or the Certificate of Incorporation or these By-Laws, the holders of a majority of the outstanding capital stock entitled to vote at the meeting, present in person or represented by proxy, shall constitute a quorum. If a quorum is once present at the meeting, the stockholders may continue to transact business until adjournment notwithstanding the withdrawal of enough stockholders to leave less than a quorum.

Section 2.07. Adjourned Meetings. The stockholders present, though less than a quorum, may, by majority vote, adjourn the meeting from time to time to a later day or hour or to another place. If the adjournment is for more than thirty (30) days, or if after adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting. Otherwise, notice of any adjourned meeting need not be given if the time and place thereof are announced at the meeting at which the adjournment is taken. At an adjourned meeting at which a quorum is present or represented by proxy, any business may be transacted which might have been transacted at the meeting as originally convened.

Section 2.08. Voting. Unless otherwise provided in the Certificate of Incorporation, each stockholder entitled to vote at any meeting of stockholders shall have one

vote for each share of stock having voting power upon the matter in question which is held by such stockholder and registered in the stockholder's name on the books of the Corporation as of the applicable record date. All elections of directors shall be conducted by written ballot, unless the Certificate of Incorporation otherwise provides. The vote upon any other question before a meeting need not be by written ballot, and need not be conducted by inspectors, unless otherwise determined by the Board of Directors or the officer presiding at the meeting. At all meetings of stockholders for the election of directors a plurality of the votes cast shall be sufficient to elect such directors. All other elections and questions at a meeting shall be decided by a majority vote of the number of shares entitled to vote represented at the meeting at the time of the vote except where otherwise required by statute, the Certificate of Incorporation or these By-Laws.

Section 2.09. Proxies. Each stockholder entitled to vote at a meeting of stockholders may authorize another person or persons to act for him or her by proxy in any manner, including without limitation via telephone, Internet or such other manner as permitted by Section 212 of the Delaware General Corporation Law, as amended from time to time, provided that such authorization sets forth or contains information from which the Corporation can determine that the authorization was granted by the stockholder. If the authorization is granted in a manner other than in a written form, the proxy holder shall provide such reasonable verification as required by the Corporation. If any such authorization designates two or more persons to act as proxies, a majority of such persons present at the meeting, or, if only one shall be present, then that one, shall have and may exercise all of the powers conferred by such authorization upon all of the persons so designated unless such authorization shall otherwise provide.

Section 2.10. Fixing Date for Determination of Stockholders of Record.

(a) In order that the Corporation may determine the stockholders entitled (i) to notice of or to vote at any meeting of stockholders or any adjournment thereof, or (ii) to express consent to corporate action in writing without a meeting, or (iii) to receive payment of any dividend or other distribution or allotment of any rights, or to exercise any rights in respect of any change, conversion or exchange of stock, or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which shall be (X) not more than sixty (60) nor less than ten (10) days before the date of any such meeting; (Y) not more than ten (10) days after the date upon which the resolution fixing the record date for any written action is adopted by the Board of Directors; and (Z) not more than sixty (60) days prior to any other action.

(b) If no record date is fixed:

(i) The record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given, or, if notice is waived, at

the close of business on the day next preceding the day on which the meeting is held.

(ii) The record date for determining stockholders entitled to express consent to corporate action in writing without a meeting, (A) when no prior action by the Board of Directors is necessary, shall be the day on which the first signed written consent setting forth the action taken or proposed to be taken is delivered to the Corporation, and (B) when prior action by the Board of Directors is necessary, shall be at the close of business on the day on which the Board of Directors adopts the resolution taking such prior action.

(iii) The record date for determining stockholders for any other purpose shall be at the close of business on the day on which the Board of Directors adopts the resolution relating thereto.

(c) A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

Section 2.11. Stockholder List. The officer of the Corporation who has charge of the stock ledger of the Corporation shall prepare and make, at least ten (10) days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten (10) days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held. The list also shall be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present. The stock ledger shall be the only evidence as to who are the stockholders entitled to examine the stock ledger, the list of stockholders or the books of the Corporation, or to vote in person or by proxy at any meeting of stockholders.

### III. BOARD OF DIRECTORS

Section 3.01. General Powers; Organization. The business of the Corporation shall be managed by or under the direction of its Board of Directors, which may exercise all such powers of the Corporation and do all such lawful acts and things as are not by statute or by the Certificate of Incorporation or by these By-Laws directed or required to be exercised or done by the stockholders. The Board of Directors may annually elect a Chairman of the Board from among its members who shall preside at its meetings, or in his or her absence the President shall so preside, or in his or her absence a chairman chosen at the meeting shall so preside. The Secretary shall act as secretary of the meeting, but in his or her absence the



chairman of the meeting may appoint any person to act as secretary of the meeting. Any meeting of the Board of Directors may be held within or without the State of Delaware.

Section 3.02. Number, Qualification and Term of Office. The number of directors constituting the Board of Directors shall be fixed from time to time by resolution of the Board of Directors. The directors shall be elected at the annual meeting of the stockholders, except as provided in Section 3.03 of these By-Laws, and each director elected shall hold office for the term elected and until his or her successor is duly elected and qualified. Any director may resign at any time upon giving written notice to the Corporation. Directors need not be stockholders.

Section 3.03. Vacancies.

(a) Vacancies and newly created directorships resulting from any increase in the authorized number of directors may be filled by a majority of the directors then in office, in their sole discretion and whether or not constituting less than a quorum, and the directors so chosen shall hold office until the next election of the class for which such directors shall have been chosen and until their successors to such class are duly elected and qualified, or until their earlier resignation, retirement or removal.

(b) Whenever the holders of any class or classes of stock or series thereof are entitled to elect one or more directors by the provisions of the Certificate of Incorporation of the Corporation, vacancies and newly created directorships of such class or classes or series may be filled by a majority of the directors elected by such class or classes or series thereof then in office, or by a sole remaining director so elected.

Section 3.04. Regular Meetings. Regular meetings of the Board of Directors may be held without notice at such time and place as may be designated from time to time by the Board of Directors.

Section 3.05. Special Meetings. Special meetings of the Board of Directors may be called from time to time by the Chairman, if any, or the President, and, upon request by any two directors, shall be called by the Chairman or the President.

Section 3.06. Notice of Special Meetings. Notice of each special meeting of the Board of Directors stating the place, date and hour of the meeting shall be given to each director by mail not less than forty-eight (48) hours, or personally or by telephone, telegram, telex or cable not less than twenty-four (24) hours, before the date and hour of the meeting.

Section 3.07. Waiver of Notice. Notice of any meeting of the Board of Directors may be waived either before, at or after such meeting in a writing signed by each director or directors to whom the notice was not duly given. Attendance of a director at a meeting shall constitute a waiver of notice of such meeting, except when the director attends

the meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

Section 3.08. Quorum. Unless otherwise specifically provided by law, the Certificate of Incorporation or these By-Laws, at all meetings of the Board of Directors, a majority of the total number of directors shall constitute a quorum for the transaction of business, and the vote of a majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors. If a quorum shall not be present at any meeting of the Board of Directors, the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

Section 3.09. Committees of Directors.

(a) The Board of Directors may, by resolution adopted by a majority of the total number of directors, designate one or more committees, each committee to consist of one or more of the directors of the Corporation and to have such name as may be determined by the Board of Directors. The Board of Directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee.

(b) Any committee, to the extent allowed by law and provided in the resolution designating the committee, may exercise the powers of the Board of Directors in the management of the business and affairs of the Corporation and may authorize the corporate seal, if any, to be affixed to all papers that may require it.

(c) Each committee shall keep regular minutes of its proceedings and report the same to the Board of Directors when required. Unless the Board of Directors otherwise provides, each committee may make, alter and repeal rules for the conduct of its business. In the absence of such rules each committee shall conduct its business in the same manner as the Board of Directors conducts its business pursuant to these By-Laws.

Section 3.10. Conference Communications. Directors may participate in any meeting of the Board of Directors, or of any duly constituted committee thereof, by means of a conference telephone conversation or other comparable method of communication by which all persons participating in the meeting can hear and communicate with each other. For the purpose of establishing a quorum and taking any action at the meeting, such directors participating pursuant to this Section 3.10 shall be deemed present in person at the meeting; and the place of the meeting shall be the place of origination of the conference telephone conversation or other comparable method of communication.

Section 3.11. Action by Written Consent of Directors. Any action required or permitted to be taken at a meeting of the Board of Directors or any committee thereof may be taken without a meeting if all directors or committee members consent thereto in writing and

the writing or writings are filed with the minutes of proceedings of the Board of Directors or the committee.

Section 3.12. Compensation. The Board of Directors shall have the authority to fix the compensation of directors.

Section 3.13. Nomination Procedures. No person (other than a person nominated by or at the direction of the Board of Directors) shall be eligible for election as a director at any annual or special meeting unless timely notice is given in writing of such nomination by a stockholder of record to the President of the Corporation. To be timely, a stockholder's notice must be delivered to or mailed to and received at, the principal executive offices of the Corporation not less than sixty (60) days prior to the date fixed for the meeting; provided, however, that in the event that less than seventy-five (75) days' prior public disclosure of the date of the meeting is given or made to stockholders, notice by the stockholder to be timely must be received not later than the close of business on the fifteenth (15th) day following the day on which such public disclosure was made.

#### IV. OFFICERS

Section 4.01. Number. The Board of Directors shall elect a President, a Secretary and a Treasurer, and it may, if it so determines, elect a Chairman of the Board from among its members. The Board of Directors also may choose one or more Vice-Presidents, one or more Assistant Secretaries, one or more Assistant Treasurers or any other officers or agents as the Board of Directors by a majority vote of the total number of directors may designate. Any person may hold two or more offices.

Section 4.02. Election, Term of Office and Qualifications. The Board of Directors shall elect the officers of the Corporation, who shall hold their offices for such terms and shall exercise such powers and perform such duties not inconsistent with these By-Laws as shall be determined from time to time by the Board of Directors. All officers of the Corporation shall hold their offices until their respective successors are elected and qualified, or until their respective offices are eliminated by vote of the majority of all directors, or until their earlier resignation, retirement or removal. Officers may be, but need not be, directors. Any officer may resign at any time upon written notice to the Corporation.

Section 4.03. Compensation. The salaries of the officers of the Corporation shall be fixed from time to time by the Board of Directors or by the chief executive officer if authorized by the Board of Directors.

Section 4.04. Removal and Vacancies. Any officer may be removed from office, with or without cause, by a majority vote of the total number of directors, but such removal shall be without prejudice to the contract rights of such officer, if any, with the Corporation. Any vacancy occurring in any office of the Corporation may be filled by the Board of Directors.

Section 4.05. Chief Executive Officer. The Board of Directors shall designate the Chairman or the President as the chief executive officer of the Corporation. If there be no Chairman, the President shall be the chief executive officer. The chief executive officer shall have the general powers and duties of management and supervision usually vested in and imposed upon the chief executive officer of a corporation. The chief executive officer shall preside at all meetings of the stockholders.

Section 4.06. Chairman of the Board. The Chairman, if one is elected, shall preside at all meetings of the Board of Directors. During the absence or disability of the President, the Chairman shall exercise all the powers and discharge all the duties of the President.

Section 4.07. President. The President, subject to the control of the Board of Directors and the Chairman (if the Chairman is the chief executive officer of the Corporation), shall have general supervision of the business of the Corporation, shall maintain the stock ledger and prepare the stockholder list as required by these By-Laws, and shall see that all orders and resolutions of the Board of Directors are carried into effect. During the absence or disability of the Chairman or if there be no Chairman, the President shall preside at all meetings of the Board of Directors.

Section 4.08. Vice-Presidents. During the absence or disability of the Chairman and the President, the Vice-President (or in the event there be more than one Vice-President, the Vice-Presidents in the order designated by the Board of Directors or, in the absence of any designation, in the order they were first elected as Vice-Presidents) shall perform the duties and have the authority of the President.

Section 4.09. Secretary. The Secretary shall keep the minutes of the meetings of the stockholders, the Board of Directors and any committees in a book to be kept for that purpose and shall perform such other ministerial duties as the Board of Directors of the Corporation may direct. The Secretary shall duly give notice of all meetings of the stockholders, special meetings of the Board of Directors and meetings of its committees, if any. The Secretary shall not be deemed an executive officer of the Corporation.

Section 4.10. Treasurer. The Treasurer shall keep accurate accounts of all moneys of the Corporation received or disbursed. He or she shall deposit all moneys, drafts and checks in the name of and to the credit of the Corporation in such banks and depositories as a majority of the whole Board of Directors shall from time to time designate. The Treasurer shall have power to endorse for deposit all notes, checks and drafts received by the Corporation. He or she shall disburse the funds of the Corporation as ordered by the Board of Directors, making proper vouchers therefor. The Treasurer shall render to the Board of Directors or the chief executive officer of the Corporation, whenever required, an account of all his or her transactions as Treasurer and of the financial condition of the Corporation.

Section 4.11. Authority and Other Duties. All officers of the Corporation shall be subject to the supervision and direction of the Board of Directors and, in addition to the foregoing authority and duties, all officers of the Corporation shall respectively have such authority and perform such other duties in the management of the business of the Corporation as may be designated from time to time by the Board of Directors. Unless prohibited by a resolution approved by the affirmative vote of a majority of the directors present, an officer elected or appointed by the Board may, without the approval of the Board, delegate some or all of the duties and powers of his or her office to other persons.

## V. INDEMNIFICATION

Section 5.01. Indemnification. The Corporation shall indemnify such persons, for such expenses and liabilities, in such manner, under such circumstances, and to such extent, as required or permitted by subsections (a) through (e) of Section 145 of the Delaware General Corporation Law, as amended from time to time.

Section 5.02. Insurance. The Corporation may purchase and maintain insurance on behalf of any person who is or was a director or officer of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against any liability asserted against and incurred by such person in or arising from that capacity, whether or not the Corporation would otherwise be required or permitted to indemnify the person against the liability. The Company shall not be obligated under these By-Laws to make any payment in connection with any claim made against any person if and to the extent that such person has actually received payment therefor under any insurance policy or policies.

Section 5.03. Indemnification Upon a Change of Control.

(a) If a Change in Control (as defined in this Section 5.03) has occurred and the person seeking indemnification so requests, a determination of whether such person is eligible for indemnification under Section 5.01 hereof shall be made in a written opinion rendered by independent legal counsel chosen by the person seeking indemnification and not reasonably objected to by the Board of Directors (whose fees and expenses shall be paid by the Corporation) and such determination shall be binding on the Corporation.

(b) For purposes of Section 5.03(a), "independent legal counsel" shall mean legal counsel other than an attorney, or a firm having associated with it an attorney, who has been retained by or has performed services for the Corporation or the person seeking indemnification within the previous three years.

(c) For purposes of Section 5.03(a), a "Change in Control" shall be deemed to have occurred if:

(i) a majority of the directors of the Corporation shall be persons other than persons (A) who were directors of the Corporation at July 1, 1989, (B) for whose election proxies shall have been solicited by the Board of Directors, or (C) who are then serving as directors appointed by the Board of Directors to fill vacancies on the Board of Directors caused by newly-created directorships or the death or resignation (but not removal) of a director;

(ii) any "person" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Act")), other than the Corporation, a subsidiary of the Corporation or the person seeking indemnification, and other than a person who acquires or becomes the beneficial owner (as defined in Rule 13d-3 under the Act, or any successor rule thereto), directly or indirectly, of twenty percent or more of the then outstanding shares of voting stock of the Corporation as a result of the merger of Digiboard, Inc., a Minnesota corporation, with and into the Corporation, together with its "affiliates" and "associates" (as those terms are defined in Rule 12b-2 under the Act), or any group of persons acting in concert, not including the person seeking indemnification, acquires or becomes a beneficial owner (as so defined in Rule 13d-3), directly or indirectly, of twenty percent or more of the then outstanding shares of voting stock of the Corporation; or

(iii) the stockholders of the Corporation approve a definitive agreement or plan to (A) merge or consolidate the Corporation with or into another corporation (other than (1) a merger or consolidation with a subsidiary of the Corporation, or (2) a merger in which the Corporation is the surviving corporation and no outstanding voting stock of the Corporation (other than fractional shares) held by stockholders immediately prior to the merger is converted into cash, securities, or other property), (B) exchange, pursuant to a statutory exchange of shares of voting stock of the Corporation held by stockholders of the Corporation immediately prior to the exchange, shares of one or more classes or series of voting stock of the Corporation for shares of another corporation, (C) sell or otherwise dispose of all or substantially all of the assets of the Corporation (in one transaction or a series of transactions), or (D) liquidate or dissolve the Corporation, unless a majority of the voting stock (or the voting equity interest) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Corporation (in the case of a merger, consolidation or disposition of assets) or the Corporation (in the case of a statutory share exchange) is, immediately following the merger, consolidation, statutory share exchange or disposition of assets, beneficially owned by the person seeking indemnification or a group of persons, including the person seeking indemnification, acting in concert; or

(iv) the Corporation enters into an agreement in principle or a definitive agreement relating to an event described in clause (i), (ii) or (iii)

above which ultimately results in an event described therein, or a tender or exchange offer or proxy contest is commenced which ultimately results in an event described therein.

Section 5.04. Good Faith Defined, Etc. For purposes of any determination of whether a person is entitled to indemnification, such person shall be deemed to have acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the Corporation, or, with respect to any criminal action or proceeding, to have had no reasonable cause to believe his or her conduct was unlawful, if such person relied on the records or books of account of the Corporation or other enterprise, or on information supplied to him or her by the officers of the Corporation or other enterprise, or on information or records given or reports made to the Corporation or other enterprise by an independent certified public accountant or by an appraiser or other expert selected with reasonable care by the Corporation or other enterprise. The term "other enterprise" as used in this Section 5.04 shall mean any enterprise other than the Corporation, including any corporation, partnership, joint venture, trust, employee benefit plan or other enterprise as to which such person is or was serving at the request of the Corporation as a director, officer, employee, agent or trustee. The provisions of this Section 5.04 shall not be deemed to be exclusive or to limit in any way the circumstances in which a person may be deemed to have met the applicable standard of conduct set forth in Section 145 of the Delaware General Corporation Law, as amended from time to time.

Section 5.05. Right to Indemnification Upon Application; Procedure Upon Application; Etc.

(a) Any indemnification under these By-Laws shall be made no later than forty-five (45) days after receipt by the Corporation of the written request of the director or officer, or former director or officer, unless a determination is made within said 45-day period in accordance with Section 5.03 that such person has not met the applicable standard of conduct.

(b) The right to indemnification or expense advances under these By-Laws shall be enforceable by the director or officer, or former director or officer, in any court of competent jurisdiction. Following a Change in Control (as defined in Section 5.03(c)), the burden of proving that indemnification is not appropriate shall be on the Corporation. Neither the absence of any prior determination that indemnification is proper in the circumstances, nor a prior determination that indemnification is not proper in the circumstances, shall be a defense to the action or create a presumption that the director or officer, or former director or officer, has not met the applicable standard of conduct. The expenses (including attorneys' fees and expenses) incurred by the director or officer, or former director or officer, in connection with successfully establishing his or her right to indemnification, in whole or in part, in any such action (or in any action or claim brought by him or her to recover under any insurance policy or policies referred to in Section 5.02) also shall be indemnified by the Corporation.

(c) If any person is entitled under any provision of these By-Laws to indemnification by the Corporation for some or a portion of expenses, judgments, fines, penalties or amounts paid in settlement incurred by him or her, but not, however, for the total amount thereof, the Corporation shall nevertheless indemnify such person for the portion of such expenses, judgments, fines, penalties and amounts to which he or she is entitled.

Section 5.06. Certain Persons Not Entitled to Indemnification. Notwithstanding any other provision of these By-Laws, no person shall be entitled to indemnification or expense advances under these By-Laws with respect to any action, suit, proceeding or claim brought or made by him or her against the Corporation, other than an action, suit, proceeding or claim seeking, or defending such person's right to, indemnification and/or expense advances pursuant to these By-Laws or otherwise.

Section 5.07. Non-Exclusivity and Survival of Indemnification. Except as otherwise provided in Section 5.06, but notwithstanding any other provision of these By-Laws, it is the policy of the Corporation that indemnification and expense advances shall be made to the fullest extent permitted by law, and, accordingly, in the event of any change in law, by legislation or otherwise, permitting greater indemnification and/or expense advances, the provisions of these By-Laws shall be construed so as to require such greater indemnification and/or expense advances. The provisions of these By-Laws shall not be deemed to preclude the indemnification of any person whom the Corporation has the power to indemnify under the provisions of the General Corporation Law of the State of Delaware or otherwise. All rights to indemnification and advancement of expenses under these By-Laws shall be deemed to be provided by a contract between the Corporation and the director or officer who serves in such capacity at any time while these By-Laws are in effect. Any repeal or modification of the indemnification provisions of these By-Laws shall not affect any rights or obligations then existing. The Corporation may provide additional indemnification rights to a director or officer of the Corporation by separate agreement.

Section 5.08. Successors; Meaning of "Corporation". The indemnification provisions of these By-Laws shall be binding upon and enforceable against any direct or indirect successor by purchase, merger, consolidation or otherwise to all or substantially all of the business and/or assets of the Corporation. For purposes of these By-Laws, but subject to the provisions of any agreement relating to any merger or consolidation of the kind referred to in clause (a) below or of any agreement relating to the acquisition of any corporation of the kind referred to in clause (b) below, references to "the Corporation" shall include (a) any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger with the Corporation which, if its separate existence had continued, would have had power and authority to indemnify its directors and officers, so that any person who is or was a director or officer of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or trustee of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, shall stand in the same position under the provisions of these By-Laws with



respect to the Corporation as he or she would have with respect to such constituent corporation if its separate existence had continued; and (b) any corporation of which at least a majority of the voting power (as represented by its outstanding stock having voting power generally in the election of directors) is owned directly or indirectly by the Corporation.

Section 5.09. Severability. The indemnification provisions of these By-Laws shall be severable in the event that any provision hereof (including any provision within a single section, subsection, clause, paragraph or sentence) is held invalid, void or otherwise unenforceable on any ground by any court of competent jurisdiction. In the event of any such holding, the remaining indemnification provisions of these By-Laws shall continue in effect and be enforceable to the fullest extent permitted by law.

## VI. STOCK

Section 6.01. Certificated and Uncertificated Shares. Shares of stock of the Corporation shall be represented by certificates, provided that the Board of Directors may provide by resolution or resolutions that some or all of any or all classes or series of stock may be uncertificated shares. Any such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the Corporation. Certificates representing shares shall be in such form as shall be prescribed by the Board of Directors, certifying the number of shares owned by the holder. Shares represented by certificates shall be numbered in the order in which they shall be issued and shall be signed in the name of the Corporation by the Chairman, the President or a Vice-President, and by the Treasurer or an Assistant Treasurer, or the Secretary or an Assistant Secretary, and the seal of the Corporation, if any, shall be affixed thereto.

Section 6.02. Issuance of Stock. The Board of Directors is authorized to cause to be issued stock of the Corporation up to the full amount authorized by the Certificate of Incorporation in such amounts and for such consideration as may be determined by the Board of Directors. No shares shall be allotted except in consideration of cash, labor, personal property, or real property, or leases thereof, or of an amount transferred from surplus to stated capital upon a stock dividend. At the time of such allotment of stock, the Board of Directors shall state its determination of the fair value to the Corporation in monetary terms of any consideration other than cash for which shares are allotted. The amount of consideration to be received in cash or otherwise shall not be less than the par value of the shares so allotted. Stock so issued shall be fully paid and nonassessable. Treasury shares may be disposed of by the Corporation for such consideration as may be fixed by the Board of Directors.

Section 6.03. Partly Paid Stock. The Corporation may issue the whole or any part of its stock as partly paid and subject to call for the remainder of the consideration to be paid therefor. Upon the face or back of each certificate issued to represent any such partly paid stock, or upon the stock ledger in the case of uncertificated shares, the total amount of the consideration to be paid therefor and the amount paid thereon shall be stated. The Board of Directors may, from time to time, demand payment in respect of each share of stock not

fully paid, of such sum of money as the necessities of the business may, in the judgment of the Board of Directors, require, not exceeding in the whole the balance remaining unpaid on such stock, and such sum so demanded shall be paid to the Corporation at such times and by such installments as the Board of Directors shall direct.

Section 6.04. Registered Stockholders. The Corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

Section 6.05. Transfers of Stock. Transfers of stock shall be made on the books of the Corporation only by the record holder of such stock, or such holder's legal representative or duly authorized attorney-in-fact, and, in the case of stock represented by a certificate, upon surrender of the certificate or the certificates for such stock. Upon surrender to the Corporation or the transfer agent of the Corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignation or authority to transfer, it shall be the duty of the Corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books. No new certificate or certificates shall be issued in exchange for any existing certificate until such certificate shall have been so cancelled, except in cases provided for in Section 6.06.

Section 6.06. Lost, Stolen or Destroyed Certificates. Any stockholder claiming a certificate for stock to be lost, stolen or destroyed shall make an affidavit of that fact in such form as the Corporation may require and shall, if the Corporation so requires, give the Corporation a bond of indemnity in form, in an amount, and with one or more sureties satisfactory to the Corporation, to indemnify the Corporation against any claims which may be made against it on account of the alleged loss, theft or destruction of the certificate or issuance of such new certificate. A new certificate may then be issued in the same tenor and for the same number of shares as the one claimed to have been lost, stolen or destroyed.

Section 6.07. Facsimile Signatures. Whenever any certificate is countersigned by a transfer agent or by a registrar other than the Corporation or one of its employees, then the signatures of the officers or agents of the Corporation may be facsimiles. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed on any such certificate shall cease to be such officer, transfer agent or registrar before such certificate is issued, it nevertheless may be issued by the Corporation as though the person who signed such certificate or whose facsimile signature or signatures had been placed thereon were such officer, transfer agent or registrar at the date of issue.

## VII. MISCELLANEOUS

Section 7.01. Dividends. The Board of Directors may declare at any regular or special meeting dividends from the Corporation's surplus, or if there be none, out of its net profits for the current fiscal year and/or the preceding fiscal year, in such amounts as in their opinion the condition of the affairs of the Corporation shall render it advisable unless otherwise restricted by law. Dividends may be paid in cash, in property or in shares of capital stock of the Corporation, subject to the provisions of the Certificate of Incorporation.

Section 7.02. Interested Directors and Officers. No contract or transaction between the Corporation and one or more of its directors or officers, or between the Corporation and any other corporation, partnership, association or other organization in which one or more of its directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for that reason, or solely because the director or officer is present at or participates in the meeting of the Board of Directors or committee thereof which authorizes the contract or transaction, or solely because his, her or their votes are counted for such purpose, if: (a) the material facts as to his or her relationship or interest and as to the contract or transaction are disclosed or are known to the Board of Directors or the committee, and the Board of Directors or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or (b) the material facts as to his or her relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or (c) the contract or transaction is fair as to the Corporation as of the time it is authorized, approved or ratified, by the Board of Directors, a committee thereof, or the stockholders. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or of a committee which authorizes the contract or transaction.

Section 7.03. Voting Securities Held by the Corporation. Unless otherwise ordered by the Board of Directors, powers of attorney, proxies, waivers of notice of meeting, consents and other instruments relating to securities owned by the Corporation may be executed in the name of and on behalf of the Corporation by the Chairman or the President, and either such officer may, in the name of and on behalf of the Corporation, take all such action as such officer may deem advisable to vote in person or by proxy at any meeting of security holders of other corporations in which the Corporation may hold securities, and at any such meeting such officer shall possess and may exercise any and all rights and powers incident to the ownership of such securities that the Corporation might have possessed and exercised if it had been present. The Board of Directors may from time to time confer like powers upon any other person or persons.

Section 7.04. Execution of Instruments.

(a) All deeds, mortgages, bonds, checks, contracts and other instruments pertaining to the business and affairs of the Corporation shall be signed on behalf of the Corporation by the Chairman, the President or any Vice President, or by such other person or persons as may be designated from time to time by the Board of Directors.

(b) If a document must be executed by persons holding different offices or functions and one person holds such offices or exercises such functions, that person may execute the document in more than one capacity if the document indicates each such capacity.

Section 7.05. Advances. The Corporation may, without a vote of the directors, advance money to its directors, officers or employees to cover expenses that can reasonably be anticipated to be incurred by them in the performance of their duties and for which they would be entitled to reimbursement in the absence of an advance.

Section 7.06. Fiscal Year. The fiscal year end of the Corporation shall be September 30 or such other date as may be fixed from time to time by resolution of the Board of Directors.

Section 7.07. Corporate Seal. The corporate seal, if one is adopted by the Board of Directors, shall be circular in form and shall have inscribed thereon the name of the Corporation, the word "Delaware" and the words "Corporate Seal." The seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise placed on any document requiring it.

Section 7.08. Power to Amend. These By-Laws may be altered, amended or repealed or new By-Laws may be adopted as provided in the Certificate of Incorporation of the Corporation.

**CERTIFICATION PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002**

I, Joseph T. Dunsmore, President, Chief Executive Officer and Chairman of Digi International Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Digi International Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's Board of Directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

May 8, 2007

/s/ Joseph T. Dunsmore

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Joseph T. Dunsmore,

President, Chief Executive Officer and Chairman

**CERTIFICATION PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002**

I, Subramanian Krishnan, Senior Vice President, Chief Financial Officer and Treasurer of Digi International Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of Digi International Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's Board of Directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

May 8, 2007

/s/ Subramanian Krishnan  
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Subramanian Krishnan  
Senior Vice President, Chief Financial Officer and Treasurer

**CERTIFICATION PURSUANT TO SECTION 906 OF THE  
SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Digi International Inc. (the Registrant) on Form 10-Q for the fiscal quarter ending March 31, 2007 as filed with the Securities and Exchange Commission on the date hereof, each of the undersigned certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Quarterly Report on Form 10-Q complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

May 8, 2007

/s/ Joseph T. Dunsmore

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Joseph T. Dunsmore  
President, Chief Executive Officer, and Chairman

/s/ Subramanian Krishnan

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Subramanian Krishnan  
Senior Vice President, Chief Financial Officer and Treasurer