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

FORM 10-Q

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

For the quarterly period ended: December 31, 2019

OR

o **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: 1-34033

DIGI INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

Delaware	**41-1532464**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
9350 Excelsior Blvd., Suite 700 **Hopkins, Minnesota**	**55343**
(Address of principal executive offices)	(Zip Code)

(952) 912-3444
(Registrant’s telephone number, including area code)

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

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, par value $.01 per share	DGII	The Nasdaq Stock Market LLC

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files.) Yes ☑ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer	o	Accelerated filer	☑
Non-accelerated filer	o	Smaller reporting company	o
Emerging growth company	o		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

On February 3, 2020, there were 28,890,105 shares of the registrant’s $.01 par value Common Stock outstanding.

INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	Three months ended December 31,	
	2019	2018
	(in thousands, except per share data)	
Revenue:		
Product	$ 54,247	$ 54,980
Service	8,070	7,333
Total revenue	62,317	62,313
Cost of sales:		
Cost of product	28,491	28,669
Cost of service	2,561	3,121
Amortization	801	740
Total cost of sales	31,853	32,530
Gross profit	30,464	29,783
Operating expenses:		
Sales and marketing	12,061	11,657
Research and development	10,331	9,518
General and administrative	8,555	3,117
Restructuring reversal	—	(67)
Total operating expenses	30,947	24,225
Operating (loss) income	(483)	5,558
Other (expense) income, net:		
Interest income	231	208
Interest expense	(432)	(92)
Other (expense) income, net	(236)	48
Total other (expense) income, net	(437)	164
(Loss) income before income taxes	(920)	5,722
Income tax (benefit) expense	(1,128)	1,040
Net income	$ 208	$ 4,682
Net income per common share:		
Basic	$ 0.01	$ 0.17
Diluted	$ 0.01	$ 0.17
Weighted average common shares:		
Basic	28,467	27,513
Diluted	29,614	28,075

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

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three months ended December 31,	
	2019	2018
	(in thousands)	
Net income	$ 208	$ 4,682
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustment	2,660	(1,569)
Change in net unrealized gain on investments	—	5
Less income tax expense	—	(2)
Other comprehensive income (loss), net of tax	2,660	(1,566)
Comprehensive income	$ 2,868	$ 3,116

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

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	December 31, 2019	September 30, 2019
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 49,072	$ 92,792
Accounts receivable, net	81,097	56,417
Inventories	47,380	39,764
Other current assets	7,486	3,574
Total current assets	185,035	192,547
Property, equipment and improvements, net	13,206	13,857
Intangible assets, net	130,973	30,667
Goodwill	214,804	153,422
Deferred tax assets	424	7,330
Other non-current assets	16,462	875
Total assets	$ 560,904	$ 398,698
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 23,165	$ 21,183
Accrued compensation	7,146	8,733
Unearned revenue	6,415	5,025
Contingent consideration on acquired businesses	14,766	5,407
Current portion of long-term debt	1,972	—
Other current liabilities	8,061	4,110
Total current liabilities	61,525	44,458
Income taxes payable	1,139	1,192
Deferred tax liabilities	18,585	261
Long-term debt	105,470	—
Other non-current liabilities	17,870	3,809
Total liabilities	204,589	49,720
Contingencies (see Note 14)		
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; 35,225,918 and 34,608,003 shares issued	352	346
Additional paid-in capital	272,393	266,567
Retained earnings	162,127	161,919
Accumulated other comprehensive loss	(22,855)	(25,515)
Treasury stock, at cost, 6,431,413 and 6,367,428 shares	(55,702)	(54,339)
Total stockholders' equity	356,315	348,978
Total liabilities and stockholders' equity	$ 560,904	$ 398,698

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

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

	Three months ended December 31,	
	2019	2018
	(in thousands)	
Operating activities:		
Net income	$ 208	$ 4,682
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation of property, equipment and improvements	1,169	1,133
Amortization of intangible assets	2,448	2,540
Stock-based compensation	1,600	1,414
Deferred income tax provision	234	1,333
Gain on sale of property and equipment	—	(4,396)
Change in fair value of contingent consideration	259	243
Provision for bad debt and product returns	50	206
Provision for inventory obsolescence	455	450
Restructuring reversal	—	(67)
Other	161	113
Changes in operating assets and liabilities (net of acquisitions)	(28,651)	(1,540)
Net cash (used in) provided by operating activities	(22,067)	6,111
Investing activities:		
Proceeds from maturities and sales of marketable securities	—	491
Acquisition of businesses, net of cash acquired	(136,098)	—
Proceeds from sale of property and equipment	—	10,047
Purchase of property, equipment, improvements and certain other intangible assets	(196)	(1,775)
Net cash (used in) provided by investing activities	(136,294)	8,763
Financing activities:		
Proceeds from long-term debt	110,000	—
Payments for contingent consideration	—	(161)
Proceeds from stock option plan transactions	4,160	662
Proceeds from employee stock purchase plan transactions	286	289
Purchases of common stock	(1,577)	(964)
Net cash provided by (used in) financing activities	112,869	(174)
Effect of exchange rate changes on cash and cash equivalents	1,772	(492)
Net (decrease) increase in cash and cash equivalents	(43,720)	14,208
Cash and cash equivalents, beginning of period	92,792	58,014
Cash and cash equivalents, end of period	$ 49,072	$ 72,222
Supplemental schedule of non-cash investing and financing activities:		
Transfer of inventory to property, equipment and improvements	$ (186)	$ (200)
Contingent consideration recognized related to acquisition of business	$ (9,100)	$ —
Accrual for purchase of property, equipment, improvements and certain other intangible assets	$ —	$ (2,883)

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

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)

	Common Stock		Treasury Stock		Additional Paid-In	Retained	Accumulated Other Comprehensive	Total Stockholders'
(in thousands)	Shares	Par Value	Shares	Value	Capital	Earnings	Loss	Equity
Balances, September 30, 2018	33,813	$ 338	6,385	$ (54,216)	$ 255,936	$ 151,961	$ (23,526)	$ 330,493
Net income						4,682		4,682
Other comprehensive loss							(1,566)	(1,566)
Employee stock purchase plan issuances			(33)	288	1			289
Repurchase of common stock			84	(964)				(964)
Issuance of stock under stock award plans	263	3			659			662
Stock-based compensation expense					1,414			1,414
Balances, December 31, 2018	34,076	$ 341	6,436	$ (54,892)	$ 258,010	$ 156,643	$ (25,092)	$ 335,010
Balances, September 30, 2019	34,608	$ 346	6,367	$ (54,339)	$ 266,567	$ 161,919	$ (25,515)	$ 348,978
Net income						208		208
Other comprehensive income							2,660	2,660
Employee stock purchase plan issuances			(25)	214	72			286
Repurchase of common stock			89	(1,577)				(1,577)
Issuance of stock under stock award plans	618	6			4,154			4,160
Stock-based compensation expense					1,600			1,600
Balances, December 31, 2019	35,226	$ 352	6,431	$ (55,702)	$ 272,393	$ 162,127	$ (22,855)	$ 356,315

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 unaudited condensed consolidated financial statements of Digi International Inc. (“we”, “us”, “our”, “Digi” or “the Company”) have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission applicable to interim financial statements. While these financial statements reflect all normal recurring adjustments that are, in the opinion of management, necessary for fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. These financial statements should be read in conjunction with the financial statement disclosures in our Annual Report on Form 10-K for the year ended September 30, 2019 (the “2019 Financial Statements”). We use the same accounting policies in preparing quarterly and annual financial statements. The quarterly results of operations are not necessarily indicative of the results to be expected for the full year.

Recently Issued Accounting Pronouncements

Adopted

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, *Leases (Topic 842)*, which provides for comprehensive changes to lease accounting. The standard requires that a lessee recognize a lease obligation liability and a right-to-use asset for virtually all leases, subsequently amortized over the lease term.

We adopted this standard in the first quarter of fiscal 2020, following the modified retrospective application approach by applying the new standard to all applicable leases existing at the date of initial application and not restating comparative periods. We are substantially complete with our implementation efforts. These efforts have included identification and analysis of our lease portfolio, analysis and evaluation of the new reporting and disclosure requirements of the new guidance, and an evaluation of our lease-related processes and internal controls. The adoption of this standard resulted in the recognition of a right-of-use asset included in other non-current assets of approximately $14.1 million and a lease liability of approximately $17.9 million included in other current liabilities and other non-current liabilities on our condensed consolidated balance sheet in the first quarter of fiscal 2020. In adopting the new standard, we elected the package of practical expedients permitted under the transition guidance, as well as the practical expedient not to separate non-lease components from lease components. We also elected the practical expedient to use hindsight in determining the lease term when considering options to extend or terminate a lease, options to purchase the underlying asset, and in assessing the impairment of right-of-use assets. The adoption of this standard did not have a significant impact on our condensed consolidated results of operations or condensed consolidated statements of cash flows. We have identified new and updated existing internal controls and processes to support measurement, recognition and disclosure under this new standard, but such changes were not deemed to be material to our overall system of internal control over financial reporting.

Not Yet Adopted

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement - Disclosure Framework (Topic 820).* The updated guidance improves the disclosure requirements on fair value measurements. The updated guidance is effective for us in the first quarter ending December 31, 2020. Early adoption is permitted for any removed or modified disclosures. We are evaluating when to adopt, and the impact of adopting, ASU 2018-13 on our consolidated financial statements.

In June 2016, FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*. The amendments in this update replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses. This update is intended to provide financial statement users with more decision-useful information about the expected credit losses. This ASU is effective for us in the first quarter ending December 31, 2020. Entities may early adopt beginning after December 15, 2018. We are evaluating the impact of adopting ASU 2016-13 on our consolidated financial statements.

2. ACQUISITIONS

Acquisition of Opengear, Inc.

On December 13, 2019, we completed our acquisition of Opengear, Inc. (“Opengear”), a New Jersey-based provider of secure IT infrastructure products and software. Opengear results are included in our condensed consolidated financial statements within our IoT Products & Services segment.

The terms of the acquisition included an upfront cash payment as well as contingent consideration comprised of future earn-out payments. We funded the closing of the acquisition with cash of $148.1 million comprised of cash on hand and proceeds from our credit facility (see Note 13 to the condensed consolidated financial statements). The future earn-out payments are based on revenue performance from Opengear for the periods ended December 31, 2019 and ending December 31, 2020. The cumulative amount of these earn-outs for the periods ended December 31, 2019 and ending December 31, 2020, will not exceed $5.0 million and $10.0 million, respectively. The fair value of this contingent consideration was $9.1 million at both the date of acquisition and at December 31, 2019 (see Note 5 to the condensed consolidated financial statements).

For tax purposes, this acquisition is treated as a stock acquisition. The goodwill therefore is not deductible. We believe this is a complementary acquisition for us as it significantly enhances our IoT Products and Services segment by providing secure, resilient access and automation to critical IT infrastructure.

The Opengear acquisition has been accounted for using the acquisition method of accounting. This requires, among other things, that assets acquired and liabilities assumed pursuant to the purchase agreement be recognized at fair value as of the acquisition date. The following table summarizes the preliminary values of Opengear assets acquired and liabilities assumed as of the acquisition date (in thousands):

Cash	$	148,058
Contingent consideration		9,100
Total	$	157,158

Fair value of net tangible assets acquired	$	19,032
Identifiable intangible assets:		
Customer relationships		81,000
Purchased and core technology		13,700
Trademarks		8,000
Deferred tax liability on identifiable intangible assets		(25,053)
Goodwill		60,479
Total	$	157,158

The condensed consolidated balance sheet as of December 31, 2019 reflects the preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. Given the timing of the Opengear acquisition, the estimated fair value of the net assets acquired, liabilities assumed and identifiable intangible assets are preliminary and remain subject to change. Included in the fair value of net tangible assets acquired was $1.4 million of right-of-use asset included in other non-current assets and $1.7 million of lease liability included in other current liabilities and other non-current liabilities associated with Opengear’s operating leases.

The preliminary weighted average useful life for all the identifiable intangibles listed above is estimated to be 13.6 years. For purposes of determining fair value, the existing customer relationships identified above are assumed to have a useful life of 14.5 years, purchased and core technology is assumed to have useful life of 9.0 years and trademarks are assumed a useful life of 12.0 years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which we expect to derive benefits from the identifiable intangible assets. The identifiable intangible assets are amortized using the straight-line method which reflects the pattern in which the assets are expected to be consumed.

Costs directly related to the acquisition of $0.3 million incurred in the fourth quarter of fiscal 2019 and $1.9 million incurred in fiscal 2020 have been charged directly to operations and are included in general and administrative expense in our condensed consolidated statements of operations. These acquisition costs include legal, accounting, valuation and investment banking fees.

2. ACQUISITIONS (CONTINUED)

The following consolidated pro forma information is presented as if the acquisition had occurred on October 1, 2018 (in thousands):

	Three months ended December 31,	
	2019	2018
Net sales	$ 77,213	$ 75,667
Net income	$ 3,499	$ 3,141
Net income per share - basic	$ 0.12	$ 0.11
Net income per share - diluted	$ 0.12	$ 0.11

Pro forma net income has been adjusted to include interest expense related to debt incurred as a result of the acquisition, amortization on the fair value of the intangibles acquired and remove any costs incurred with the sale transaction. Net income for the three months ended December 31, 2018 was adjusted to include acquisition-related costs of $2.3 million.

3. EARNINGS PER SHARE

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):

	Three months ended December 31,	
	2019	2018
Numerator:		
Net income	$ 208	$ 4,682
Denominator:		
Denominator for basic net income per common share — weighted average shares outstanding	28,467	27,513
Effect of dilutive securities:		
Stock options and restricted stock units	1,147	562
Denominator for diluted net income per common share — adjusted weighted average shares	29,614	28,075
Net income per common share, basic	$ 0.01	$ 0.17
Net income per common share, diluted	$ 0.01	$ 0.17

For the three months ended December 31, 2019 and 2018, there were 594,447 and 1,241,964 potentially dilutive shares, respectively, related to stock options to purchase common shares that were not included in the above computation of diluted earnings per common share since the options’ exercise prices were greater than the average market price of our common shares.

4. SELECTED BALANCE SHEET DATA

The following table shows selected balance sheet data (in thousands):

	December 31, 2019	September 30, 2019
Accounts receivable, net:		
Accounts receivable	$ 85,004	$ 60,062
Less allowance for doubtful accounts	940	968
Less reserve for future returns and pricing adjustments	2,967	2,677
Accounts receivable, net	$ 81,097	$ 56,417
Inventories:		
Raw materials	$ 17,149	$ 12,308
Work in process	—	565
Finished goods	30,231	26,891
Inventories	$ 47,380	$ 39,764

5. FAIR VALUE MEASUREMENTS

Financial assets and liabilities are classified in the following fair value hierarchy based on the lowest level input that is significant to the fair value measurement: Level 1 (unadjusted quoted prices in active markets for identical assets or liabilities); Level 2 (observable market inputs, other than quoted prices included in Level 1); and Level 3 (unobservable inputs that cannot be corroborated by observable market data). The following tables provide information by level for financial assets and liabilities that are measured at fair value on a recurring basis (in thousands):

	Total Fair Value at December 31, 2019	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Liabilities:				
Contingent consideration on acquired businesses	$ 14,766	$ —	$ —	$ 14,766
Total liabilities measured at fair value	$ 14,766	$ —	$ —	$ 14,766

	Total Fair Value at September 30, 2019	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Assets:				
Money market	$ 56,700	$ 56,700	$ —	$ —
Total assets measured at fair value	$ 56,700	$ 56,700	$ —	$ —
Liabilities:				
Contingent consideration on acquired businesses	$ 5,407	$ —	$ —	$ 5,407
Total liabilities measured at fair value	$ 5,407	$ —	$ —	$ 5,407

In connection with our acquisition of Bluenica Corporation (“Bluenica”) in October 2015, we agreed to make contingent earn-out payments over a period of up to four years, subject to achieving specified revenue thresholds for sales of Bluenica products. To date, we have paid a total of $2.7 million for contingent consideration. The fair value of the remaining liability for the contingent consideration period was $3.3 million at December 31, 2019.

In connection our acquisition of TempAlert in October 2017, we agreed to make contingent earn-out payments for the twelve month periods ending December 31, 2018 and December 31, 2019 based on the total Digi IoT Solutions segment revenue. The fair value of the liability for contingent consideration was zero at December 31, 2019. The earn-out period for this acquisition ended on December 31, 2019.

In connection with our acquisition of Accelerated in January 2018, we agreed to make contingent earn-out payments if specified revenue thresholds for sales of Accelerated products were achieved. We made the first installment payment of $3.5 million in the third quarter of fiscal 2019. The fair value of the liability for contingent consideration for the acquisition of Accelerated

5. FAIR VALUE MEASUREMENTS (CONTINUED)

was $2.3 million at December 31, 2019. The earn-out period for this acquisition ended on January 22, 2020.

In connection with our acquisition of Opengear, Inc., we agreed to make contingent payments, based upon certain revenue thresholds (see Note 2 to the condensed consolidated financial statements). The fair values of the liability for contingent consideration for the acquisition of Opengear was $9.1 million at December 31, 2019.

The following table presents a reconciliation of the contingent consideration liability measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

	Three months ended December 31,	
	2019	2018
Fair value at beginning of period	$ 5,407	$ 10,065
Contingent consideration recognized for acquired business	9,100	—
Contingent consideration payments	—	(161)
Change in fair value of contingent consideration	259	243
Fair value at end of period	$ 14,766	$ 10,147

The change in fair value of contingent consideration reflects our estimates of the probabilities of achieving the relevant targets and is discounted based on our estimated discount rate. We have estimated the fair value of the contingent consideration at December 31, 2019 based on the probability of achieving the specified revenue thresholds at 100% for Bluenica, 0% for TempAlert, 100% for Accelerated and 64% for Opengear. A significant change in our estimates of achieving any relevant target could materially change the fair value of the contingent consideration liability.

6. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Amortizable intangible assets were (in thousands):

	December 31, 2019			September 30, 2019		
	Gross carrying amount	Accum. amort.	Net	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	$ 71,772	$ (52,097)	$ 19,675	$ 57,699	$ (50,986)	$ 6,713
License agreements	102	(81)	21	102	(74)	28
Patents and trademarks	22,636	(12,263)	10,373	14,577	(11,970)	2,607
Customer relationships	127,557	(26,893)	100,664	46,315	(25,266)	21,049
Non-compete agreements	600	(360)	240	600	(330)	270
Order backlog	1,800	(1,800)	—	1,800	(1,800)	—
Total	$ 224,467	$ (93,494)	$ 130,973	$ 121,093	$ (90,426)	$ 30,667

Amortization expense was $2.4 million and $2.5 million for the three month periods ended December 31, 2019 and 2018, respectively. Amortization expense is recorded on our condensed consolidated statements of operations within cost of sales and in general and administrative expense.

Estimated amortization expense related to intangible assets for the remainder of fiscal 2020 and the five succeeding fiscal years is (in thousands):

2020 (nine months)	$ 12,029
2021	$ 15,210
2022	$ 14,366
2023	$ 12,167
2024	$ 11,464
2025	$ 8,007

6. GOODWILL AND OTHER INTANGIBLE ASSETS, NET (CONTINUED)

The changes in the carrying amount of goodwill by reportable segments are (in thousands):

	Three months ended December 31,		
	IoT Products and Services	IoT Solutions	Total
Balance on September 30, 2019	$ 103,519	$ 49,903	$ 153,422
Acquisitions	60,479	—	60,479
Foreign currency translation adjustment	730	173	903
Balance at December 31, 2019	$ 164,728	$ 50,076	$ 214,804

Goodwill represents the excess of cost over the fair value of net identifiable assets acquired. Goodwill is tested for impairment on an annual basis as of June 30, or more frequently if events or circumstances occur which could indicate impairment. There were no triggering events identified for the three months ended December 31, 2019. For our quantitative goodwill impairment tests, we determine the estimated fair value of each reporting unit and compare it to the carrying value of the reporting unit, including goodwill. If the carrying amount of a reporting unit is higher than its estimated fair value, then an impairment loss must be recognized for the excess. Both of our operating segments constitute separate reporting units and both units were tested individually for impairments.

The fair value of each reporting unit is determined using a weighted combination of an income and market approach. A discounted cash flow (“DCF”) method is utilized for the income approach. In developing the discounted cash flow analysis, our assumptions about future revenues, expenses, capital expenditures, and changes in working capital are based on management’s projections, and assume a terminal growth rate thereafter. A separate discount rate is determined for each reporting unit and these cash flows are then discounted to determine the fair value of the reporting unit. The market approach determines a value derived from the guideline company method. This market approach method estimates the price reasonably expected to be realized from the sale of the reporting unit based on comparable companies.

Assumptions and estimates to determine fair values under the income and market approaches are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. If our future operating results do not meet current forecasts or if we experience a sustained decline in our market capitalization that is determined to be indicative of a reduction in fair value of one or more of our reporting units, we may be required to record future impairment charges for goodwill.

Results of our Fiscal 2019 Annual Impairment Test

As of June 30, 2019, we had a total of $104.0 million of goodwill for the IoT Products & Services reporting unit and $50.0 million of goodwill for the IoT Solutions reporting unit. At June 30, 2019, fair value exceeded the carrying value by more than 10% for both reporting units. Implied fair values for both reporting units were each calculated on a standalone basis using a weighted combination of the income approach and market approach. The implied fair values of each reporting unit were added together to get an indicated value of total equity to which a range of indicated value of total equity was derived. This range was compared to the total market capitalization of $356.6 million as of June 30, 2019, which implied a range of control premiums of 13.3% to 20.3%. This range of control premiums fell below the control premiums observed in the last five years in the communications equipment industry. As a result, the market capitalization reconciliation analysis proved support for the reasonableness of the fair values estimated for each individual reporting unit.

7. SALE OF BUILDING

On October 2, 2018, we sold a 130,000 square feet building that served as our corporate headquarters in Minnetonka, Minnesota to Minnetonka Leased Housing Associates II, LLLP. The sale price was $10.0 million in cash adjusted for certain selling costs and an escrow for the leaseback of the building for four months. As a result of this sale, we recorded a gain of $4.4 million ($3.4 million net of tax) in the first quarter of fiscal 2019, which was recorded in general and administrative expense.

8. SEGMENT INFORMATION

We have two reportable operating segments: IoT Products & Services, and IoT Solutions. Summary operating results for each of our segments were (in thousands):

	Three months ended December 31,			
	2019		2018	
Revenue				
IoT Products & Services	$	54,613	$	53,294
IoT Solutions		7,704		9,019
Total revenue	$	62,317	$	62,313
Operating (loss) income				
IoT Products & Services	$	2,388	$	7,402
IoT Solutions		(2,871)		(1,844)
Total operating (loss) income	$	(483)	$	5,558
Depreciation and amortization				
IoT Products & Services	$	1,706	$	1,942
IoT Solutions		1,911		1,731
Total depreciation and amortization	$	3,617	$	3,673

Total expended for property, plant and equipment was (in thousands):

	Three months ended December 31,			
	2019		2018	
Expended for property, equipment and improvements				
IoT Products & Services	$	190	$	1,775
IoT Solutions*		6		—
Total expended for property, plant and equipment	$	196	$	1,775

* Excluded from this amount is $186 and $200 of transfers of inventory to property plant and equipment for subscriber assets for the three months ended December 31, 2019 and 2018, respectively.

Total assets for each of our segments were (in thousands):

	December 31, 2019		September 30, 2019	
Assets				
IoT Products & Services	$	415,843	$	215,651
IoT Solutions		95,989		90,255
Unallocated*		49,072		92,792
Total assets	$	560,904	$	398,698

*Unallocated consists of cash and cash equivalents and current marketable securities.

9. REVENUE

Revenue Disaggregation

The following summarizes our revenue by geographic location of our customers:

	Three months ended December 31,			
($ in thousands)	2019		2018	
North America, primarily the United States	$	47,536	$	46,335
Europe, Middle East & Africa		8,516		10,104
Rest of world		6,265		5,874
Total revenue	$	62,317	$	62,313

9. REVENUE (CONTINUED)

The following summarizes our revenue by the timing of revenue recognition:

	Three months ended December 31,	
($ in thousands)	2019	2018
Transferred at a point in time	$ 56,300	$ 57,463
Transferred over time	6,017	4,850
Total revenue	$ 62,317	$ 62,313

Contract Balances

Contract Assets

Contract assets consist of subscriber assets. These subscriber assets relate to fees in certain contracts that we charge our customers so they can begin using equipment. In these cases, we retain the ownership of the equipment that the customer uses. The total net book value of subscriber assets of $2.0 million and $2.1 million as of December 31, 2019 and September 30, 2019, respectively, are included in property, equipment and improvements, net. Depreciation expense for these subscriber assets, which is included in cost of sales, was $0.3 million and $0.2 million for the three month periods ended December 31, 2019 and December 31, 2018, respectively. We depreciate the cost of this equipment over its useful life (typically three years).

Contract Liabilities

The timing of revenue recognition may differ from the timing of invoicing to customers. Customers are invoiced for subscription services in advance on a monthly, quarterly or annual basis. Contract liabilities consist of unearned revenue related to annual or multi-year contracts for subscription services and related implementation fees for our IoT Solutions segment and our Digi Remote Manager® services in our IoT Products & Services segment.

Changes in unearned revenue were:

($ in thousands)	Three months ended December 31, 2019
Unearned revenue, beginning of period	$ 5,025
Billings	9,847
Revenue recognized	(8,070)
Unearned revenue, end of period	$ 6,802

Remaining Transaction Price

Transaction price allocated to the remaining performance obligations represents contracted revenue that has not been recognized. This includes unearned revenue and unbilled amounts that will be recognized as revenue in future periods. As of December 31, 2019 approximately $13.2 million of revenue is expected to be recognized from remaining performance obligations for subscription contracts. We expect to recognize revenue on approximately $8.4 million of remaining performance obligations over the next twelve months. Revenue from the remaining performance obligations we expect to recognize over a range of two to seven years.

10. INCOME TAXES

Our income tax benefit was $1.1 million for the three months ended December 31, 2019. Included in this benefit was a net tax benefit discretely related to the three months ended December 31, 2019 of $1.0 million. This benefit primarily was the result of excess tax benefits recognized on stock compensation and an adjustment of our state deferred tax rate due to the Opengear acquisition. For the three months ended December 31, 2019, our effective tax rate before items discretely related to the period was less than the U.S. statutory rate due primarily to certain income tax credits generated in the U.S.

Income tax expense was $1.0 million for the three months ended December 31, 2018. Included in this expense was a net tax benefit discretely related to the three months ended December 31, 2018 of $0.1 million. This expense primarily was the result of expiring statute of limitations of uncertain tax benefits as well as excess tax benefits recognized on stock compensation. For the three months ended December 31, 2018, our effective tax rate before items discretely related to the period was less than the U.S. statutory rate primarily due to certain income tax credits generated in the U.S.

10. INCOME TAXES (CONTINUED)

Our effective tax rate will vary based on a variety of factors. These include our overall profitability, the geographical mix of income before taxes and related statutory tax rate in each jurisdiction, and tax items discretely related to the period, such as settlements of audits. We may record other benefits or expenses in the future that are specific to a particular quarter such as expiration of statutes of limitation, the completion of tax audits, or legislation that is enacted in both U.S. and foreign jurisdictions.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is (in thousands):

Unrecognized tax benefits as of September 30, 2019	$	1,713
Decreases related to:		
Settlements		(7)
Expiration of statute of limitations		(39)
Unrecognized tax benefits as of December 31, 2019	$	1,667

The total amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate is $1.5 million, after considering the impact of interest and deferred benefit items. We expect that the total amount of unrecognized tax benefits will decrease by approximately $0.3 million over the next 12 months.

11. PRODUCT WARRANTY OBLIGATION

The following table summarizes the activity associated with the product warranty accrual (in thousands) and is included on our condensed consolidated balance sheets within current liabilities:

Period		Balance at October 1		Warranties issued		Settlements made		Balance at December 31
Three months ended December 31, 2019	$	1,012	$	74	$	(87)	$	999
Three months ended December 31, 2018	$	1,172	$	72	$	(104)	$	1,140

12. LEASES

Our leases primarily consist of operating leases for office space. All of our leases are operating leases. For any lease with an initial term in excess of twelve months, the related lease assets and lease liabilities are recognized on the condensed consolidated balance sheets as either operating or financing leases at the inception of an agreement where it is determined that a lease exists. We have lease agreements that contain both lease and non-lease components, and we have elected to combine lease and non-lease components for all classes of assets. Leases with an initial term of twelve months or less are not recorded on the condensed consolidated balance sheets. Instead we recognize lease expense for these leases on a straight-line basis over the lease term.

Operating lease assets represent the right to use an underlying asset for the lease term and operating lease liabilities represent the obligation to make lease payments. These assets and liabilities are recognized based on the present value of future payments over the lease term at the commencement date. We generally use a collateralized incremental borrowing rate based on information available at the commencement date, including the lease term, in determining the present value of future payments. Our lease terms generally do not include options to extend or terminate the lease unless it is reasonably certain that the option will be exercised.

Our leases typically require payment of real estate taxes and common area maintenance and insurance. These components comprise the majority of our variable lease cost and are excluded from the present value of our lease obligations. Fixed payments may contain predetermined fixed rent escalations. We recognize the related rent expense on a straight-line basis from the commencement date to the end of the lease term.

12. LEASES (CONTINUED)

The following table shows the supplemental balance sheet information related to our leases (in thousands):

	Balance Sheet Location		December 31, 2019
Assets			
Operating leases	Other non-current assets	$	15,041
Total lease assets		$	15,041
Liabilities			
Operating leases	Other current liabilities	$	1,926
Operating leases	Other non-current liabilities		17,483
Total lease liabilities		$	19,409

Components of our lease cost were as follows (in thousands):

	Statement of Operations Location		Three months ended December 31, 2019
Operating lease cost	Cost of goods sold and SG&A	$	852
Variable lease cost	Cost of goods sold and SG&A		23
Total lease cost		$	875

The following table below presents supplemental information related to operating leases (in thousands):

		Three months ended December 31, 2019
Cash paid for amounts included in the measurement of operating lease liabilities	$	416
Right-of-use assets obtained in exchange for new operating lease liabilities	$	—

	December 31, 2019
Weighted average remaining lease term - operating leases	8.0 years
Weighted average discount rate - operating leases	4.50%

The table below reconciles the undiscounted cash flows for each of the first five years as well as all the remaining years to the operating lease liabilities recorded on the condensed consolidated balance sheet as of December 31, 2019 (in thousands):

Fiscal year		Amount
Remainder of 2020	$	2,296
2021		3,070
2022		2,732
2023		2,420
2024		2,150
2025		2,142
Thereafter		9,219
Total future undiscounted lease payments		24,029
Less imputed interest		(4,620)
Total reported lease liability	$	19,409

12. LEASES (CONTINUED)

As follows, aggregate annual future minimum rental commitments under operating leases with noncancelable terms of more than one year at September 30, 2019 were reported under previous lease accounting standards (in thousands):

Fiscal year	Amount
2020	$ 2,596
2021	2,575
2022	2,314
2023	2,056
2024	2,095
Thereafter	11,361
Total minimum payments required	$ 22,997

13. DEBT

In connection with our acquisition of Opengear, we entered into a syndicated credit agreement with BMO Harris Bank N.A. (“BMO”) on December 13, 2019. This agreement provided us with committed credit facilities (the “Credit Facility”) totaling $150 million, consisting of (i) a $50 million term loan (the “Term Loan”) and (ii) a $100 million revolving loan (the “Revolving Loan”).

Borrowings under the Credit Facility bear interest rates based on an underlying variable benchmark plus applicable margin based on our total leverage. Interest rates for both the Term Loan and Revolving Loan reset quarterly. Our weighted average interest rate for the three months ended December 31, 2019 was 4.5%.

In addition to paying interest on the outstanding balance under the Credit Facility, we are required to pay a commitment fee on the non-utilized commitments thereunder. We also incurred debt issuance costs under the Credit Facility of $2.6 million in the first quarter of fiscal 2020, which is being amortized using the straight-line method over the term of the loan. Both the commitment fee and the amortization costs of the debt issuance costs are reported in interest expense.

Amounts under the Term Loan will be repaid in quarterly installments on the last day of each fiscal quarter, with amortization of 5% in the first two years, 7.5% in the next two years and 10% in the final year. The remaining outstanding balance will mature on December 13, 2024. The Revolving Loan is due in a lump sum payment at maturity on December 13, 2024.

Our Term Loan and Revolving Loan contains two financial covenants that require us to stay below a maximum debt-to-earnings before interest, taxes, depreciation and amortization (“EBITDA”) ratio and maintain a minimum ratio of interest expense-to-EBITDA. Both ratios are computed quarterly, with EBITDA calculated on a rolling four-quarter basis.

The fair values of the Term Loan and Revolving Loan approximated carrying value at December 31, 2019, due to the variable interest rates on these instruments.

The following table is a summary of our long-term indebtedness at December 31, 2019 (in thousands):

Revolving loan	$	60,000
Term loan		50,000
Total loans		110,000
Less unamortized issuance costs		(2,558)
Less current maturities of long-term debt		(1,972)
Total long-term debt, net of current portion	$	105,470

Covenants and Security Interest

The agreements governing the Credit Facility contain a number of covenants that, among other things, require us to maintain a certain financial ratio (net leverage ratio and minimum fixed charge ratio). At December 31, 2019, we were in compliance with these debt covenants. Amounts borrowed under the Credit Facility are secured by substantially all of our assets.

14. CONTINGENCIES

Contingencies

In November 2018, DimOnOff Inc., a company headquartered in Quebec City, Quebec, Canada (“DimOnOff”), which sells control systems in the building automation and street lighting markets sued us and a former distributor from whom DimOnOff purchased certain of our products. The suit was brought in the Superior Court of the Province of Quebec in the District of Quebec (Canada) and alleges certain Digi products it purchased and incorporated into street lighting systems in a Canadian city were defective causing some of the street lights to malfunction. It alleges damages of just over CAD 1.0 million. We intend to defend ourselves against DimOnOff’s claims. At this time we cannot assess the likelihood or amount of any potential loss.

In addition to the matter discussed above, in the normal course of business, we are subject to various claims and litigation. There can be no assurance that any claims by third parties, if proven to have merit, will not materially adversely affect our business, liquidity or financial condition.

15. STOCK-BASED COMPENSATION

Stock-based awards were granted under the 2019 Omnibus Incentive Plan (the “2019 Plan”) beginning February 4, 2019, prior to that date such awards made in fiscal 2019 were granted under the 2018 Omnibus Incentive Plan (the “2018 Plan”). Upon stockholder approval of the 2019 Plan, we ceased granting awards under the 2018 Plan. Shares subject to awards under the 2018 Plan or any prior plans that are forfeited, canceled, returned to us for failure to satisfy vesting requirements, settled in cash or otherwise terminated without payment also will be available for grant under the 2019 Plan. The authority to grant options under the 2019 Plan and to set other terms and conditions rests with the Compensation Committee of the Board of Directors.

The 2019 Plan authorizes the issuance of up to 1,500,000 common shares in connection with awards of stock options, stock appreciation rights, restricted stock, restricted stock units, performance-based full value awards or other stock-based awards. Eligible participants include our employees, our affiliates, non-employee directors of our Company and any consultant or advisor who is a natural person and provides services to us or our affiliates. Options that have been granted under the 2019 Plan typically vest over a four-year period and will expire if unexercised after seven years from the date of grant. Restricted stock unit awards (“RSUs”) that have been granted to directors typically vest in one year. RSUs that have been granted to executives and employees typically vest in January over a four-year period. The 2019 Plan is scheduled to expire on February 3, 2029. Options under the 2019 Plan can be granted as either incentive stock options or non-statutory stock options. The exercise price of options and the grant date price of RSUs is determined by our Compensation Committee but will not be less than the fair market value of our common stock based on the closing price as of the date of grant. Upon exercise of options or settlement of vested restricted stock units, we issue new shares of stock. As of December 31, 2019, there were approximately 628,921 shares available for future grants under the 2019 Plan.

Our equity plans and corresponding forms of award agreements generally have provisions allowing employees to elect to satisfy tax withholding obligations through the delivery of shares, having us retain a portion of shares issuable under the award or paying cash to us for the withholding. During the three months ended December 31, 2019 and 2018, our employees forfeited 88,723 shares and 83,988 shares, respectively, in order to satisfy respective withholding tax obligations of $1.6 million and $1.0 million.

Employee contributions to the Employee Stock Purchase Plan (the “ESPP”) were $0.3 million for both the three month periods ended December 31, 2019 and 2018. Pursuant to the ESPP, 24,738 and 33,706 common shares were issued to employees during the three months ended December 31, 2019 and 2018, respectively. Shares are issued under the ESPP from treasury stock. As of December 31, 2019, 179,802 common shares were available for future issuances under the ESPP.

15. STOCK-BASED COMPENSATION (CONTINUED)

As follows, stock-based compensation expense is included in the consolidated results of operations (in thousands):

	Three months ended December 31,	
	2019	2018
Cost of sales	$ 64	$ 55
Sales and marketing	431	353
Research and development	294	200
General and administrative	811	806
Stock-based compensation before income taxes	1,600	1,414
Income tax benefit	(332)	(294)
Stock-based compensation after income taxes	$ 1,268	$ 1,120

Stock Options

The following table summarizes our stock option activity (in thousands, except per common share amounts):

	Options Outstanding	Weighted Average Exercised Price	Weighted Average Contractual Term (in years)	Aggregate Intrinsic Value (1)
Balance at September 30, 2019	3,348	$10.85		
Granted	594	17.71		
Exercised	(404)	10.31		
Forfeited / Canceled	(35)	11.27		
Balance at December 31, 2019	3,503	$12.08	4.5	$ 19,868
Exercisable at December 31, 2019	2,015	$10.58	3.4	$ 14,378

(1) The aggregate intrinsic value represents the total pre-tax intrinsic value, based on our closing stock price of $17.72 as of December 31, 2019, which would have been received by the option holders had all option holders exercised their options as of that date. 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 three months ended December 31, 2019 was $3.0 million and during the three months ended December 31, 2018 was $0.3 million.

The table below shows the weighted average fair value, which was determined based upon the fair value of each option on the grant date utilizing the Black-Scholes option-pricing model and the related assumptions:

	Three months ended December 31,	
	2019	2018
Weighted average per option grant date fair value	$6.56	$4.36
Assumptions used for option grants:		
Risk free interest rate	1.67% - 1.73%	2.78% - 2.93%
Expected term	6.00 years	6.00 years
Expected volatility	36%	33%
Weighted average volatility	36%	33%
Expected dividend yield	0	0

The fair value of each option award granted during the periods presented was estimated using the Black-Scholes option valuation model that uses the assumptions noted in the above table. Expected volatilities are based on the historical volatility of our stock. We use historical data to estimate option exercise and employee termination information within the valuation model. The expected term of options granted is derived from the vesting period and historical information and represents the period of time that options granted are expected to be outstanding. The risk-free rate used is the zero-coupon U.S. Treasury bond rate in effect at the time of the grant whose maturity equals the expected term of the option.

15. STOCK-BASED COMPENSATION (CONTINUED)

As of December 31, 2019, the total unrecognized compensation cost related to non-vested stock options was $7.5 million and the related weighted average period over which it is expected to be recognized is approximately 3.2 years.

Non-vested Restricted Stock Units

The table below presents a summary of our non-vested restricted stock units as of December 31, 2019 and changes during the three months then ended (in thousands, except per common share amounts):

	Number of Awards		Weighted Average Grant Date Fair Value
Nonvested at September 30, 2019	888	$	11.65
Granted	240	$	17.67
Vested	(214)	$	11.53
Canceled	(28)	$	11.04
Nonvested at December 31, 2019	886	$	13.33

As of December 31, 2019, the total unrecognized compensation cost related to non-vested restricted stock units was $10.5 million. The related weighted average period over which this cost is expected to be recognized is approximately 1.8 years.

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

Our management’s discussion and analysis should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended September 30, 2019, as well as our subsequent reports on Form 8-K and any amendments to these reports.

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.

Forward-Looking Statements

The words such as "assume," "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. Among other items, these statements relate to expectations of the business environment in which the company operates, projections of future performance, perceived marketplace opportunities and statements regarding our mission and vision. Such statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions. Among others, these include risks related to the highly competitive market in which our company operates, rapid changes in technologies that may displace products sold by us, declining prices of networking products, our reliance on distributors and other third parties to sell our products, the potential for significant purchase orders to be canceled or changed, delays in product development efforts, uncertainty in user acceptance of our products, the ability to integrate our products and services with those of other parties in a commercially accepted manner, potential liabilities that can arise if any of our products have design or manufacturing defects, our ability to defend or settle satisfactorily any litigation, uncertainty in global economic conditions and economic conditions within particular regions of the world which could negatively affect product demand and the financial solvency of customers and suppliers, the impact of natural disasters and other events beyond our control that could negatively impact our supply chain and customers, potential unintended consequences associated with restructuring or other similar business initiatives that may impact our ability to retain important employees, the ability to achieve the anticipated benefits and synergies associated with acquisitions or divestitures (including, but not limited to, our recently announced acquisition of Opengear), and changes in our level of revenue or profitability which can fluctuate for many reasons beyond our control.

These and other risks, uncertainties and assumptions identified from time to time in our filings with the United States Securities and Exchange Commission, including without limitation, our Annual Report on Form 10-K for the year ended September 30, 2019 and other filings, could cause the company’s future results to differ materially from those expressed in any forward-looking statements made by us or on our behalf. Many of such factors are beyond our ability to control or predict. These forward-looking statements speak only as of the date for which they are made. We disclaim any intent or obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Presentation of Non-GAAP Financial Measures

This report includes adjusted net income, adjusted net income per diluted share and adjusted earnings before interest, taxes and amortization ("Adjusted EBITDA"), each of which is a non-GAAP financial measure.

We understand that there are material limitations on the use of non-GAAP measures. Non-GAAP measures are not substitutes for GAAP measures, such as net income, for the purpose of analyzing financial performance. The disclosure of these measures does not reflect all charges and gains that were actually recognized by the company. These non-GAAP measures are not in accordance with, or, an alternative for measures prepared in accordance with GAAP and may be different from non-GAAP measures used by other companies or presented by us in prior reports. In addition, these non-GAAP measures are not based on any comprehensive set of accounting rules or principles. We believe that non-GAAP measures have limitations in that they do not reflect all of the amounts associated with our results of operations as determined in accordance with GAAP and that these measures should only be used to evaluate our results of operations in conjunction with the corresponding GAAP measures. Additionally, Adjusted EBITDA does not reflect our cash expenditures, the cash requirements for the replacement of depreciated and amortized assets, or changes in or cash requirements for our working capital needs.

We believe that providing historical and adjusted net income and adjusted net income per diluted share, respectively, exclusive of such items as reversals of tax reserves, discrete tax benefits, restructuring charges and reversals, intangible amortization, stock-based compensation, other non-operating income/expense, adjustments to estimates of contingent consideration, acquisition-related expenses and interest expense from acquisitions permits investors to compare results with prior periods that did not include these items. Management uses the aforementioned non-GAAP measures to monitor and evaluate ongoing operating results and trends and to gain an understanding of our comparative operating performance. In addition, certain of our stockholders have expressed an interest in seeing financial performance measures exclusive of the impact of these matters, which while important, are not central to the core operations of our business. Management believes that Adjusted EBITDA, defined as EBITDA adjusted for stock-based compensation expense, acquisition-related expenses, restructuring charges and reversals, and gains from the disposition of our former corporate headquarters is useful to investors to evaluate the company’s core operating results and financial performance because it excludes items that are significant non-cash or non-recurring items reflected in the condensed consolidated statements of operations. We believe that the presentation of Adjusted EBITDA as a percentage of revenue is useful because it provides a reliable and consistent approach to measuring our performance from year to year and in assessing our performance against that of other companies. We believe this information helps compare operating results and corporate performance exclusive of the impact of our capital structure and the method by which assets were acquired.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, the disclosure of contingent assets and liabilities and the values of purchased assets and assumed liabilities in acquisitions. We base our estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

A description of our critical accounting policies and estimates was provided in the Management’s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the fiscal year ended September 30, 2019.

OVERVIEW

We are a leading global provider of business and mission-critical Internet-of-Things ("IoT") connectivity products, services and solutions comprised of two reporting segments: IoT Products & Services and IoT Solutions.

Our IoT Products & Services segment offers products and services that help original equipment manufacturers ("OEMs"), enterprise and government customers create and deploy, secure IoT connectivity solutions. From embedded and wireless modules to console servers, enterprise and industrial routers, we provide customers with a wide variety of communication sub-assemblies and finished products to meet their IoT communication requirements. In addition, the IoT Products & Services segment provides our customers with a device management platform and other professional services to enable customers to capture and manage data from devices they connect to networks.

On December 13, 2019, we completed our acquisition of Opengear, a New Jersey based provider of secure IT infrastructure products and software. We believe that this acquisition provides our customers with an expansive, high-value, technology portfolio that is hardware enabled and software defined and is complementary to our products. Opengear results are included in our condensed consolidated financial statements within our IoT Products & Services segment.

The terms of the acquisition include an upfront cash payment together with contingent consideration comprised of future earn-out payments. We funded the acquisition with cash of $148.1 million comprised of cash on hand and proceeds from our Credit Facility (see Note 13 to the condensed consolidated financial statements). The future earn-out payments are based on revenue performance from Opengear for the periods ended December 31, 2019 and ending December 31, 2020. The cumulative amount of these earn-outs for the periods ended December 31, 2019 and ending December 31, 2020, will not exceed $5.0 million and $10.0 million, respectively. The fair value of this contingent consideration was $9.1 million at both the date of acquisition and at December 31, 2019 (see Note 5 to the condensed consolidated financial statements).

Our IoT Solutions segment offers wireless temperature and other condition-based monitoring services as well as task management services. These solutions are focused on the following vertical markets: food service, retail, healthcare (primarily pharmacies), transportation/logistics and education. These solutions are marketed as SmartSense by Digi™. We have formed, expanded and enhanced the IoT Solutions segment through four acquisitions.

For further detail on segment performance, see the Revenue by Segment and Cost of Goods Sold and Gross Profit by Segment sections of this Item 2.

We compete for customers on the basis of existing and planned product features, service and software application capabilities, company reputation, brand recognition, technical support, alliance relationships, quality and reliability, product development capabilities, price and availability.

In fiscal 2020, our key operating objectives include the following:

- continued growth of our SmartSense by Digi® business that is the base of our IoT solutions segment;
- delivering growth within our IoT Products & Services segment driven by new product introductions;
- seeking further strategic growth through potential acquisitions, such as our recent purchase of Opengear in the first quarter of fiscal 2020; and
- optimizing our reduced fixed cost footprint with third-party manufacturing.

We utilize many financial, operational, and other metrics to evaluate our financial condition and financial performance. Below we highlight the metrics for the first quarter of fiscal 2020 that we feel are most important in these evaluations:

- Consolidated revenue remained flat at $62.3 million compared to the first quarter of fiscal 2019. Product revenue decreased by $0.7 million, or 1.3%, in the first quarter of fiscal 2020 compared to the same period a year ago. Services revenue increased by $0.8 million, or 10.1%, in the first quarter of fiscal 2020 compared to the same period a year ago.

- Gross margin increased as a percentage of revenue to 48.9% in the first quarter of fiscal 2020 as compared to 47.8% in the first quarter of fiscal 2019.

- Net income for the first fiscal quarter of 2020 was $0.2 million, or $0.01 per diluted share. Net income for the first fiscal quarter of 2019 was $4.7 million, or $0.17 per diluted share. Adjusted net income and adjusted net income per share was $4.5 million, or $0.15 per diluted share. In the first fiscal quarter of fiscal 2019, adjusted net income and adjusted net income per share was $4.3 million, or $0.15 per diluted share.

- Adjusted EBITDA for the first fiscal quarter of 2020 was $6.4 million, or 10.3% of total revenue. In the first fiscal quarter of fiscal 2019, Adjusted EBITDA was $6.2 million, or 9.9% of total revenue.

Key trends regarding our existing business

The following trends affected our financial performance in fiscal 2019 and 2018, and we expect these trends will continue to impact our results in the future:

- We believe the market for IoT products and related services is in the midst of a long-term expansion. We believe our IoT Products & Services business is positioned for modest revenue and profitability growth and that our IoT Solutions business is positioned for more significant revenue growth given the large total addressable market for condition monitoring and asset tracking services that is in earlier stages of adoption.
- As recurring revenues from subscription and device cloud monitoring services continue to grow, we expect they will impact our gross margins positively as the revenue of incremental subscription additions is not offset at the same rate as expected increases in the costs associated with implementing such additions.
- We expect revenues from our network product offerings within our IoT Products & Services business will decrease over time many of which are in the mature phase of their product life cycles. Note, however, that OpenGear's products are included in network product offerings and that we believe these products are not in the mature phase of their lifecycle.

CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth selected information derived from our interim condensed consolidated statements of operations:

	Three months ended December 31,				% incr.
($ in thousands)	2019		2018		(decr.)
Revenue	$ 62,317	100.0 %	$ 62,313	100.0%	—
Cost of sales	31,853	51.1	32,530	52.2	(2.1)
Gross profit	30,464	48.9	29,783	47.8	2.3
Operating expenses	30,947	49.7	24,225	38.9	27.7
Operating (loss) income	(483)	(0.8)	5,558	8.9	(108.7)
Other (expense) income, net	(437)	(0.7)	164	0.3	(366.5)
Loss (income) before income taxes	(920)	(1.5)	5,722	9.2	(116.1)
Income tax (benefit) expense	(1,128)	(1.8)	1,040	1.7	(208.5)
Net income	$ 208	0.3 %	$ 4,682	7.5%	95.6

REVENUE BY SEGMENT

	Three months ended December 31,				% incr.
($ in thousands)	2019		2018		(decr.)
Revenue					
IoT Products & Services	$ 54,613	87.6%	$ 53,294	85.5%	2.5
IoT Solutions	7,704	12.4	9,019	14.5	(14.6)
Total revenue	$ 62,317	100.0%	$ 62,313	100.0%	—

The 2.5% increase in IoT Products & Services revenue in the first quarter of fiscal 2020 from the first quarter of fiscal 2019 was the result of:

- increased sales of our cellular products driven by sales to an existing customer that is implementing a large project;
- incremental revenue from our acquisition of Opengear; and

- increased sales of our Digi Remote Manager® and support services.

This increase partially was offset by:

- decreased sales of certain network products due to project-based sales to a customer in the prior fiscal year; and
- decreased sales of radio frequency ("RF") products and wireless design services.

The 14.6% decrease in IoT Solutions revenue in the first quarter of fiscal 2020 from the first quarter of fiscal 2019 was the result of:

- additional product purchases from existing customers in fiscal 2019 that did not reoccur in fiscal 2020.

This decrease partially was offset by:

- increased recurring revenue from our subscription services.

COST OF GOODS SOLD AND GROSS PROFIT BY SEGMENT

	Three months ended December 31,				Basis point
($ in thousands)	2019		2018		Inc. (Decr.)
Cost of Goods Sold					
IoT Products & Services	$ 27,962	51.2%	$ 27,928	52.4%	(1.2)
IoT Solutions	3,891	50.5%	4,602	51.0%	(0.5)
Total cost of goods sold	$ 31,853	51.1%	$ 32,530	52.2%	(2.1)

	Three months ended December 31,				Basis point
($ in thousands)	2019		2018		Inc. (Decr.)
Gross Profit					
IoT Products & Services	$ 26,651	48.8%	$ 25,366	47.6%	1.2
IoT Solutions	3,813	49.5%	4,417	49.0%	0.5
Total gross profit	$ 30,464	48.9%	$ 29,783	47.8%	1.1

The 1.2 percentage point increase in IoT Products & Services gross profit margin primarily was the result of:

- incremental gross profit from our acquisition of Opengear; and
- increased sales from our enterprise products, Digi Remote Manager® and support services, which have a higher gross margins.

This increase partially was offset by:

- unfavorable product mix as we experienced lower sales of RF products and certain network products, which typically have higher gross margins.

The 0.5 percent point increase in IoT Solutions gross profit margin primarily was the result of:

- revenue mix; a greater percentage of revenue in fiscal 2020 was attributed to recurring subscription revenue, which typically has higher gross margins.

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

OPERATING EXPENSES

Below is our operating expenses and operating expenses as a percentage of total revenue:

	Three months ended December 31,				$	%
($ in thousands)	2019		2018		incr. (decr.)	incr. (decr.)
Operating Expenses						
Sales and marketing	$ 12,061	19.4%	$ 11,657	18.7 %	$ 404	3.5
Research and development	10,331	16.6%	9,518	15.3 %	813	8.5
General and administrative	8,555	13.7%	3,117	5.0 %	5,438	174.5
Restructuring reversal	—	—%	(67)	(0.1)%	67	(100.0)
Total operating expenses	$ 30,947	49.7%	$ 24,225	38.9 %	$ 6,722	27.7

The $6.7 million increase in operating expenses in the first quarter of fiscal 2020 from the first quarter of fiscal 2019 primarily was the result of:

- a $4.4 million gain on the sale of our corporate headquarters recorded in the first quarter of fiscal 2019;
- an increase of $2.0 million of acquisition costs primarily related to the acquisition of Opengear; and
- incremental operating expenses from Opengear.

This increase partially was offset by:

- a reduction of $0.5 million in amortization expense as certain intangible assets have become fully amortized; and
- a $0.5 million decrease in other professional and outside services.

OTHER (EXPENSE) INCOME, NET

	Three months ended December 31,				$	%
($ in thousands)	2019		2018		incr. (decr.)	incr. (decr.)
Other (expense) income, net						
Interest income	$ 231	0.4 %	$ 208	0.3 %	$ 23	11.1
Interest expense	(432)	(0.7)%	(92)	(0.1)%	(340)	369.6
Other (expense) income, net	(236)	(0.4)%	48	0.1 %	(284)	(591.7)
Total other (expense) income, net	$ (437)	(0.7)%	$ 164	0.3 %	$ (601)	(366.5)

The $0.6 million decrease in other (expense) income, net in the first quarter of fiscal 2020 from the first quarter of fiscal 2019 primarily was the result of:

- an increase in interest expense of $0.3 million related to the balance outstanding under the Credit Facility in connection with the acquisition of Opengear on December 13, 2019 (see Note 13 to the condensed consolidated financial statements).
- an increase of $0.3 million related to foreign currency losses, primarily related to fluctuations in the Euro.

INCOME TAXES

See Note 10 to the condensed consolidated financial statements for discussion of income taxes.

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

NON-GAAP FINANCIAL INFORMATION

Below are reconciliations from GAAP to Non-GAAP information that we feel is important to our business:

Reconciliation of Net Income to Adjusted EBITDA
(In thousands)

	Three months ended December 31,			
	2019		2018	
		% of total revenue		% of total revenue
Total revenue	$ 62,317	100.0%	$ 62,313	100.0%
Net income	$ 208		$ 4,682	
Interest expense (income), net	201		(116)	
Income tax (benefit) expense	(1,128)		1,040	
Depreciation and amortization	3,617		3,673	
Stock-based compensation	1,600		1,414	
Gain on sale of building	—		(4,396)	
Restructuring reversal	—		(67)	
Acquisition expense	1,906		(69)	
Adjusted EBITDA	$ 6,404	10.3%	$ 6,161	9.9%

Reconciliation of Net Income and Net Income per Diluted Share to Adjusted Net Income and Adjusted Net Income per Diluted Share
(In thousands, except per share amounts)

	Three months ended December 31,			
	2019		2018	
Net income and net income per diluted share	$ 208	$ 0.01	$ 4,682	$ 0.17
Amortization	2,448	0.08	2,540	0.09
Stock-based compensation	1,600	0.05	1,414	0.05
Other non-operating income	236	0.01	(48)	—
Acquisition expense	1,906	0.06	(69)	—
Acquisition earn-out adjustments	259	0.01	243	0.01
Restructuring charge	—	—	(67)	—
Interest expense related to acquisition	416	0.01	—	—
Gain on sale of building	—	—	(4,396)	(0.16)
Tax effect from the above adjustments	(1,610)	(0.05)	90	—
Discrete tax benefits (1)	(959)	(0.03)	(106)	0.00
Adjusted net income and adjusted net income per diluted share (2)	$ 4,504	$ 0.15	$ 4,283	$ 0.15
Diluted weighted average common shares		29,614		28,075

(1) For the three months ended December 31, 2019, discrete tax benefits primarily include excess tax benefits recognized on stock compensation. For the three months ended December 31, 2018, discrete tax benefits are a result of expiring statute of limitations of uncertain tax benefits as well as excess tax benefits recognized on stock compensation.

(2) Adjusted net income per diluted share may not add due to the use of rounded numbers.

LIQUIDITY AND CAPITAL RESOURCES

Historically we have financed our operations and capital expenditures principally with funds generated from operations. Our liquidity requirements arise from our working capital needs, and to a lesser extent, our need to fund capital expenditures to support our current operations and facilitate growth and expansion. In the first quarter of fiscal 2020, we incurred debt of $110 million associated with our acquisition of Opengear. As of December 31, 2019, $40 million remained available under the Revolving Loan, which included $10 million available for a letter of credit subfacility and $10 million available under a swingline subfacility, the outstanding amounts of which decrease the available commitment. For additional information regarding the terms of our Credit Facility, including the Revolving Loan and its subfacilities, see Note 13 to our condensed consolidated financial statements.

We expect positive cash flows from operations. We believe that our current cash and cash equivalents balances, cash generated from operations and our ability to borrow under our credit facility will be sufficient to fund our business operations and capital expenditures for the next twelve months and beyond.

As follows, our condensed consolidated statement of cash flows for the three months ended December 31, 2019 and 2018 is summarized:

	Year ended September 30,	
($ in thousands)	2019	2018
Operating activities	$ (22,067)	$ 6,111
Investing activities	(136,294)	8,763
Financing activities	112,869	(174)
Effect of exchange rate changes on cash and cash equivalents	1,772	(492)
Net (decrease) increase in cash and cash equivalents	$ (43,720)	$ 14,208

Cash flows from operating activities decreased $28.2 million primarily as a result of:

- negative changes in operating assets and liabilities (net of acquisitions) of $27.1 million, primarily due to increased accounts receivable, lower accrued expenses and income taxes receivable both in the current fiscal year; and
- a decrease in net income of $4.5 million, partially offset by non-cash adjustments of $3.4 million. This primarily included a gain in the sale of our former corporate headquarters building in the prior fiscal year.

Cash flows from investing activities decreased $145.1 million primarily as a result of:

- net cash used of $136.1 million for the purchase of Opengear;
- proceeds of $10.0 million for the sale of our corporate headquarters building and proceeds from maturities of our marketable securities both in the prior fiscal year;
- a partial offset to these decreases was related to purchases of property, equipment, and facilities improvements (mostly related to the build-out of our new corporate headquarters space) in the prior fiscal year.

Cash flows from financing activities increased $113.0 million primarily as a result of:

- proceeds from assuming $110.0 million of debt from the Revolving Loan and Term Loan (see Note 13 to the condensed consolidated financial statements); and
- increases in proceeds from stock award plans in addition to an increase in prior year acquisition earn-out payments.

CONTRACTUAL OBLIGATIONS

The following summarizes our contractual obligations at December 31, 2019:

	Payments due by fiscal period				
($ in thousands)	Total	Less than 1 year	1-3 years	3-5 years	Thereafter
Operating leases	$ 24,557	$ 3,412	$ 5,806	$ 4,513	$ 10,826
Contingent consideration	$ 14,766	$ 14,766	$ —	$ —	$ —
Revolving loan	$ 60,000	$ —	$ —	$ 60,000	$ —
Term loan	$ 50,000	$ 2,500	$ 6,250	$ 41,250	$ —
Interest on long-term debt	$ 29,867	$ 5,160	$ 12,028	$ 12,679	$ —

The operating lease agreements included above primarily relate to office space. The table above does not include possible payments for uncertain tax positions. Our reserve for uncertain tax positions, including accrued interest and penalties, was $1.7 million as of December 31, 2019. Due to the nature of the underlying liabilities and the extended time often needed to resolve income tax uncertainties, we cannot make reliable estimates of the amount or timing of future cash payments that may be required to settle these liabilities. The above table also does not include those obligations for royalties under license agreements as these royalties are calculated based on future sales of licensed products and we cannot make reliable estimates of the amount of cash payments.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

For information on new accounting pronouncements, see Note 1 to our condensed consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to ongoing market risk related to changes in interest rates and foreign currency exchange rates.

INTEREST RATE RISK

We may be exposed to interest rate risk should we decide to invest in marketable securities. When we hold marketable securities, we classify them as available-for-sale and are carried at fair value. Our investments may consist of money market funds, certificates of deposit, commercial paper, corporate bonds and government municipal bonds. Our investment policy specifies the types of eligible investments and minimum credit quality of our investments, as well as diversification and concentration limits which mitigate our risk. We do not use derivative financial instruments to hedge against interest rate risk because the majority of our investments mature in less than one year.

We are exposed to market risks related to fluctuations in interest rates on amounts borrowed under the Credit Facility. As of December 31, 2019, we had $50.0 million outstanding under our Term Loan and $60.0 million outstanding under our Revolving Loan, subject to variable interest rates that reset quarterly based on changes in market rates and our consolidated leverage. Based on the balance sheet position for both the Term Loan and Revolving Loan at December 31, 2019, the annualized effect of a 25 basis point change in interest rates would increase or decrease our interest expense by $0.3 million. For additional information, see Note 13 to our condensed consolidated financial statements. For our Credit Facility, interest rate changes generally do not affect the fair value of the debt instruments, but do impact future earnings and cash flows, assuming other factors are held constant.

FOREIGN CURRENCY RISK

We are exposed to foreign currency transaction risk associated with certain sales transactions being denominated in Euros, British Pounds, Japanese Yen or Canadian Dollars. We are also exposed to foreign currency translation risk as the financial position and operating results of our foreign subsidiaries are translated into U.S. Dollars for consolidation. We manage our net asset or net liability position for non-functional currency accounts, primarily the U.S. Dollar accounts in our foreign locations to reduce our foreign currency risk. We have not implemented a formal hedging strategy.

For both the three months ended December 31, 2019 and 2018, we had approximately $14.8 million and $16.0 million, respectively, of revenue from foreign customers including export sales. Of these sales, $0.8 million and $1.0 million, respectively, were denominated in foreign currency, predominantly Euros and Canadian Dollar. In future periods, we expect that the majority of our sales will continue to be in U.S. Dollars. The table below compares the average monthly exchange rates of the Euro, British Pound, Japanese Yen and Canadian Dollar to the U.S. Dollar:

	Three months ended December 31,		% increase
	2019	2018	(decrease)
Euro	1.1214	1.1447	(2.0)%
British Pound	1.3159	1.2705	3.6 %
Japanese Yen	0.0092	0.0091	1.1 %
Canadian Dollar	0.7673	0.7335	4.6 %

A 10% change in the average exchange rate for the Euro, British Pound, Japanese Yen and Canadian Dollar to the U.S. Dollar during the first three months of fiscal 2020 would have resulted in a 0.1% increase or decrease in revenue and a 2.0% increase or decrease in stockholders' equity due to foreign currency translation. The above analysis does not take into consideration any pricing adjustments we might consider in response to changes in such exchange rates.

CREDIT RISK

We have 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 and customer contacts to facilitate payment.

Investments are made in accordance with our investment policy and may consist of money market funds, certificates of deposit, commercial paper, corporate bonds and government municipal bonds. The fair value of our investments contains an element of credit exposure, which could change based on changes in market conditions. If market conditions deteriorate or if the issuers of these securities experience credit rating downgrades, we may incur impairment charges for securities in our investment portfolio. All of our securities are held domestically.

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 Chief Executive Officer and Chief 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 Chief Executive Officer and Chief 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 SEC rules and forms and is accumulated and communicated to our management, including the principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting that occurred during the quarterly period ended December 31, 2019 that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The disclosure set forth under the heading “Contingencies” in Note 14 to the condensed consolidated financial statements in Part I, Item 1 of this Form 10-Q is incorporated herein by reference.

ITEM 1A. RISK FACTORS

Except as noted below, there have been no material changes in our risk factors from those previously disclosed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended September 30, 2019.

We entered into a credit facility, and failure to comply with the covenants thereunder may have a material adverse effect.

In December 2019, we entered into a credit agreement (the “Credit Agreement”) with BMO, as administrative agent and collateral agent, BMO Capital Markets Corp., as joint lead arranger and sole book runner, Silicon Valley Bank, as joint lead arranger, and other lenders from time to time party thereto (collectively, the “Lenders”), which provides us with senior secured credit facilities totaling $150 million, consisting of (i) the Term Loan and (ii) the Revolving Loan. The Revolving Loan includes a $10 million letter of credit loan and $10 million swingline loan, the outstanding amounts of which decrease the available commitment. Loans under the Term Loan will be repaid in quarterly installments on the last day of each fiscal quarter, with amortization of 5% in the first two years, 7.5% in the next two years and 10% in the final year. The remaining outstanding balance will be repaid in full after five years.

If we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments on the Credit Facility, we will be in default. We are also required to comply with several financial covenants under the Credit Agreement. Our ability to comply with such financial covenants may be affected by events beyond our control, which could result in a default under the Credit Agreement; such default may have a material adverse effect on our business, financial condition, operating results or cash flows.

The Credit Agreement also contains other customary affirmative and negative covenants, including covenants that restrict the ability of the Company and its subsidiaries to incur additional indebtedness, dispose of significant assets, make certain investments, including any acquisitions other than permitted acquisitions, make certain payments, enter into sale and leaseback transactions, grant liens on its assets or rate management transactions, subject to certain limitations. These restrictions could adversely affect our business.

We have significant international sales and operations and face risks related to health epidemics that could disrupt our operations and adversely impact our sales and operating results.

Our business could be adversely affected by the effects of a widespread outbreak of contagious disease, such as the recent outbreak of respiratory illness caused by a novel coronavirus first identified in Wuhan, Hubei Province, China. Any outbreak of contagious diseases or other adverse public health developments could have a material and adverse effect on our business operations and financial results. These effects could include disruptions or restrictions on our ability to travel or distribute our product as well as temporary closures of the facilities of our suppliers or customers and their contract manufacturers. Any disruption of our suppliers or customers and their contract manufacturers could negatively impact our sales and operating results. In addition, a significant outbreak of contagious diseases in the human population could result in a widespread health crisis that could adversely affect the economies and financial markets of many countries, resulting in an economic downturn that could affect demand for our products and likely impact our operating results.

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

The following table presents the information with respect to purchases made by or on behalf of Digi International Inc. or any “affiliated purchaser” (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of our common stock during the first quarter of fiscal 2019:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program
October 1, 2019 - October 31, 2019	766	$ 14.42	—	$ —
November 1, 2019 - November 30, 2019	65,268	$ 17.97	—	$ —
December 1, 2019 - December 31, 2019	22,689	$ 17.32	—	$ —
	88,723	$ 17.77	—	$ —

(1) All shares reported were forfeited by employees in connection with the satisfaction of tax withholding obligations related to the vesting of restricted stock units.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No.		Description	Method of Filing
2	(a)	Agreement and Plan of Merger by and among Digi International Inc., Namath Merger Sub. Inc., Opengear, Inc. and Shareholder Representative Services LLC, as representative, dated as of November 7, 2019* (1)	Incorporated by Reference
3	(a)	Restated Certificate of Incorporation of the Company, as amended (2)	Incorporated by Reference
3	(b)	Amended and Restated By-Laws of the Company (3)	Incorporated by Reference
10	(a)	Credit Agreement dated as of December 13, 2019, with BMO Harris Bank N.A., as administrative agent and collateral agent, BMO Capital Markets Corp., as joint lead arranger and sole book runner and Silicon Valley Bank, as joint lead arranger, other lenders from time to time party thereto* (4)	Incorporated by Reference
10	(b)	Commitment Letter by and among Digi International Inc., BMO Harris Bank N.A. and BMO Capital Markets Corp., dated November 7, 2019 (5)	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
101.INS		XBRL Instance Document	Filed Electronically
101.SCH		XBRL Taxonomy Extension Schema Document	Filed Electronically
101.CAL		XBRL Taxonomy Calculation Linkbase Document	Filed Electronically
101.DEF		XBRL Taxonomy Definition Linkbase Document	Filed Electronically
101.LAB		XBRL Taxonomy Label Linkbase Document	Filed Electronically
101.PRE		XBRL Taxonomy Presentation Linkbase Document	Filed Electronically

* Schedules have been omitted pursuant to Item 601(a)(5) of Regulation S-K. Digi agrees to furnish to the Commission a copy of any omitted schedule upon request.

(1) Incorporated by reference to Exhibit 2.1 to the Company’s Current Report on Form 8-K filed on November 8, 2019 (File No. 1-34033)
(2) Incorporated by reference to Exhibit 3(a) to the Company’s Annual Report on Form 10-K for the year ended September 30, 1993 (File No. 0-17972)
(3) Incorporated by reference to Exhibit 3(b) to the Company’s Current Report on Form 8-K filed on August 28, 2017 (File No. 1-34033)
(4) Incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on December 16, 2019 (File No. 1-34033)
(5) Incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on November 8, 2019 (File No. 1-34033)

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:	February 7, 2020	By:	/s/ James J. Loch
			James J. Loch
			Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer and Authorized Officer)

Exhibit No. 31(a)

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

I, Ronald E. Konezny, 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 (or persons performing the equivalent functions):

(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.

February 7, 2020

/s/ Ronald E. Konezny

Ronald E. Konezny
President and Chief Executive Officer

Exhibit No. 31(b)

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

I, James J. Loch, 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 (or persons performing the equivalent functions):

(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.

February 7, 2020	/s/ James J. Loch
	James J. Loch
	Senior Vice President, Chief Financial Officer and Treasurer

Exhibit No. 32

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 ended December 31, 2019 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.

February 7, 2020

/s/ Ronald E. Konezny

Ronald E. Konezny
President and Chief Executive Officer

/s/ James J. Loch

James J. Loch
Senior Vice President, Chief Financial Officer and Treasurer